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S. HRG. 102-161

NATURAL GAS RATEPAYERS RELIEF ACT OF 1991

HEARING

BEFORE THE

SUBCOMMITTEE ON
ENERGY REGULATION AND CONSERVATION

OF THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

S. 933

TO PROVIDE FAIR REFUNDS TO CONSUMERS OF NATURAL GAS WHO ARE FOUND TO HAVE BEEN OVERCHARGED

JUNE 19, 1991

Printed for the use of the
Committee on Energy and Natural Resources

U.S. GOVERNMENT PRINTING OFFICE
45-151 ⇆ WASHINGTON : 1991

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-035444-7

S311-62.

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NATURAL GAS RATEPAYERS RELIEF ACT OF 1991

WEDNESDAY, JUNE 19, 1991

U.S. Senate,
Subcommittee on Energy Regulation
and Conservation,
Committee on Energy and Natural Resources,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room SD-366, Dirksen Senate Office Building, Hon. Timothy E. Wirth, presiding.

OPENING STATEMENT OF HON. TIMOTHY E. WIRTH, U.S. SENATOR FROM COLORADO

Senator Wirth. The subcommittee will come to order.

Today's hearing of the Energy Regulation and Conservation Subcommittee is on S. 933, the Natural Gas Ratepayers Relief Act of 1991.

This legislation was offered by the distinguished Senator from Ohio, Howard Metzenbaum, who will be our opening witness today in support of his legislation.

Senator Metzenbaum, it is a pleasure to welcome you back to the committee and to the subcommittee which you formerly Chaired.

When he left the subcommittee, Senator Metzenbaum asked me if I would please hold a hearing on legislation which he had planned to introduce regarding FERC's rate-setting authority under the Natural Gas Act. With the introduction of S. 933, I am pleased to follow through on my commitment to Senator Metzenbaum.

S. 933 would amend sections 4 and 5 of the Natural Gas Act to change interstate pipelines' responsibilities for filing rates and providing refunds to their customers. The stated purpose of S. 933 is to protect natural gas ratepayers from overcharges. This, of course, is a laudable goal. The purpose of today's hearing is to see if this legislation would, in fact, have that result. In particular, I am going to focus on the following questions in connection with this legislation.

First, would increasing pipelines' exposure to potential refund obligations harm the financial health of the interstate pipeline industry? And if so, who would pick up the tab for that? How would it affect, in turn, natural gas ratepayers?

Second, does the same public policy rationale we use to justify expanding the refund responsibilities of electric utilities in the Regulatory Fairness Act apply to gas pipelines?

Finally, I think we need to ask how the Natural Gas Act amendments proposed in S. 933 would affect the other natural gas proposals now incorporated into S. 1220, the comprehensive energy legislation reported by the committee earlier this month.

S. 1220 would make natural gas one of the cornerstones of our national energy policy. The committee's bill included significant provisions to remove regulatory obstacles to greater natural gas utilization and to encourage natural gas consumption through research, development, commercialization, and alternative fuels programs.

The committee needs to know whether the amendments proposed in S. 933 would help or hinder achievement of the goals set in the comprehensive bill.

[The prepared statements of Senators Johnston and Wallop and the text of S. 933 follow:]

PREPARED STATEMENT OF HON. J. BENNETT JOHNSTON, U.S. SENATOR FROM LOUISIANA

It is a pleasure to welcome Senator Metzenbaum back to the Energy Committee and I look forward to hearing the Senator from Ohio's testimony in support of his legislation.

The legislation introduced by Senator Metzenbaum would amend sections 4 and 5 of the Natural Gas Act to increase the rate filing and refund obligations of interstate natural gas pipelines. For the most part, this bill is the same as an amendment that was offered by the Senator from Ohio during floor debate on the Natural Gas Wellhead Decontrol Act of 1989. The Metzenbaum amendment was tabled by the Senate.

Now, two years later, the Metzenbaum amendment has been introduced as a freestanding bill. It also may be offered again as an amendment; this time as an amendment to the natural gas title of S. 1220, the National Energy Security Act of 1991. If this happens, I will oppose the Metzenbaum amendment.

Simply put, S. 933 runs counter to the direction that the Energy Committee has taken in the natural gas provisions of its comprehensive energy legislation. Our purpose is to remove regulatory obstacles to greater natural gas utilization. One of the ways that we intend to do this is by streamlining the regulatory process at the FERC. We want to get the natural gas industry out of the FERC hearing room and into the market place.

S. 933 would accomplish just the opposite. The statutory changes proposed by this legislation would encourage more rate litigation at the FERC. This means more valuable time wasted in the hearing room and more money wasted paying lawyers. The irony is that if this legislation were to become law, the very ratepayers that it purports to protect would be the ones who would have to pay for the delay and the litigation costs that the legislation would create.

S. 933 would expose pipelines to greater risk and uncertainty. Capital markets would recognize this, and it would be reflected in higher rates of interest for pipeline borrowing. This would frustrate the pipeline expansion projects that we are trying to promote in our comprehensive legislation. Once again, S. 933 would boomerang on the very ratepayers it purports to protect. The higher cost of capital would be flowed through to natural gas consumers in the pipelines' rates.

In conclusion, S. 933 represents a step backwards in natural gas regulation. I urge my colleagues to reject this legislation.

PREPARED STATEMENT OF HON. MALCOLM WALLOP, U.S. SENATOR FROM WYOMING

Today the Subcommittee is holding a hearing on S. 933, the Natural Gas Ratepayers Relief Act of 1991.

As you know, Mr. Chairman, the provisions contained in Senator Metzenbaum's bill are similar to those which had been in our original energy security bill, S. 341. However, during markup the Committee deleted those provisions; I believe that was a wise decision.

It will be argued today that the Senator's bill is pro-consumer, but nothing could be further from the truth. If anything, enactment of this legislation would instead result in even higher natural gas prices. That is because pipelines are regulated entities, earning a rate of return on invested capital, and when setting just and reasonable rates FERC takes into consideration the risk involved. To the extent pipeline investment risk is increased—as would occur if this legislation were enacted—FERC will have to raise the rate of return, which translates directly into higher gas prices for consumers.

There are also other reasons why this bill would adversely affect consumers, on which several of the witnesses appearing before us today will testify.

Mr. Chairman, it is important to keep in mind that consumers are already protected under existing law. Before a rate can be put into effect permanently, the pipeline must prove to the satisfaction of the Commission that it is "just and reasonable." If the rate is subsequently determined to be no longer "just and reasonable," section 5 of the Natural Gas Act provides a mechanism for the Commission to review and lower the rate.

Sections 4 and 5 of the Natural Gas Act have been in place for over fifty years and have worked well. If there is any problem, it is not with the Natural Gas Act, it is with the speed by which the Commission acts on pending cases. That is a valid issue, and it is one which is being addressed by portions of S. 1220, the National Energy Strategy bill recently reported by the Committee.

I look forward to the testimony of today's witnesses.

II

102D CONGRESS
1ST SESSION

S. 933

To provide fair refunds to consumers of natural gas who are found to have been overcharged.

IN THE SENATE OF THE UNITED STATES

APRIL 25, 1991

Mr. METZENBAUM introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To provide fair refunds to consumers of natural gas who are found to have been overcharged.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Natural Gas Ratepayers Relief Act of 1991".

SEC. 2. REFUNDS FOR OVERCHARGES.

(a) AMENDMENT OF SECTION 4(e) OF THE NATURAL GAS ACT.—The third and fourth sentences of section 4(e) of the Natural Gas Act (15 U.S.C. 717c(e)) are amended to read as follows: "Where rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be changed, the burden of proof to show that the changed rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.".

(b) AMENDMENT OF SECTION 4 OF THE NATURAL GAS ACT.—Section 4 of the Natural Gas Act (15 U.S.C. 717d) is amended by adding at the end thereof the following new subsection:

"(f) Any natural-gas company subject to the jurisdiction of the Commission shall file tariff sheets restating its rates to establish new base tariff rates at least 30 days before the expiration of 36 months after the effective date of any previously approved base tariff rates.".

(c) AMENDMENT OF SECTION 5 OF THE NATURAL GAS ACT.—Section 5 of the Natural Gas Act (15 U.S.C. 717d) is amended by—

(1) redesignating subsection (b) as subsection (c); and

(2) inserting the following new subsection after subsection (a):

"(b) At the conclusion of a proceeding under this section, the Commission shall order the natural-gas company to make refunds of such amounts as have been paid, for the period subsequent to the refund effective date, in excess of those that would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract that the Commission orders to be thereafter observed and in force. The refunds shall be made, with interest, to persons who have paid the rates or charges that were the subject of the proceeding. The Commission shall establish the refund effective date. In the case of a hearing instituted on complaint, the refund effective date shall not be earlier than the date that is 60 days after the date of filing of the complaint or later than 150 days after the expiration of such 60-day period.".

(d) EFFECTIVE DATE.—(1) The amendments made by this section shall not apply to a proceeding under the

Natural Gas Act commenced before the date of enactment of this Act.

(2) A proceeding to which the amendments made by this section does not apply by reason of paragraph (1) may be withdrawn and refiled without prejudice.

(e) STUDY.—(1) Not earlier than 3 years and not later than 4 years after the date of enactment of this Act, the Commission shall perform a study of the effect of the amendments to the Natural Gas Act made by this Act.

(2) The study required by paragraph (1) shall analyze—

(A) the impact, if any, of such amendments on the cost of capital paid by natural gas companies;

(B) any change in the average time taken to resolve proceedings under sections 4 and 5 of the Natural Gas Act; and

(C) such other matters as the Commission may deem appropriate in the public interest.

(3) Upon completion the study required by paragraph (1) shall be submitted to the Committee on Energy and Natural Resources of the Senate and the Committee on Energy and Commerce of the House of Representatives.

Senator WIRTH. Senator Metzenbaum, thank you very much for being here. We look forward to hearing your testimony.

Following your testimony, we are going to ask the witnesses, both from the Department of Energy and FERC, to join with our other witnesses in one major panel.

Senator Metzenbaum, thank you very much, sir.

STATEMENT OF HON. HOWARD M. METZENBAUM, U.S. SENATOR FROM OHIO

Senator METZENBAUM. Thank you, Senator Wirth.

I am glad to have the pleasure of appearing before your subcommittee.

As you say, I had the opportunity to Chair this subcommittee at an earlier date. I think the subject that we have before us today deserves fair consideration. I am sure it will receive it from you.

The legislation has one principal objective: to create new refund rights for consumers of natural gas who, when the Federal Energy Regulatory Commission has determined, have been overcharged—in other words, consumers who have paid a rate exceeding the rate that FERC determines is just and reasonable. What could be fairer? If they have been overcharged, they are entitled to a refund.

The Chair points out the question may be where will the money come from. Would there have to be other rate increases? I think that is a fair question to ask. I am honest in saying that I think if I had been overcharged and you have to give the money back to me because you overcharged me, I am not sure that it is my concern that you may have to borrow it or you will not be able to live as well by reason of having to refund to me that which was due me.

The bill provides for the refunds in three separate ways. It amends section 4 of the Natural Gas Act, the provision of law under which pipelines seek to make their rates effective. It will amend section 5 of the Natural Gas Act, the provision under which the FERC, State commissions, local gas distribution companies, and others may file a complaint to review the appropriateness of pipeline rates. And thirdly, it requires pipelines to file a rate case at least once every 3 years to ensure that rates reflect actual current cost of service.

In the past, section 4 of the Natural Gas Act worked well enough. However, today consumers are not adequately protected. The authority to order refunds is possibly the single, most important means by which regulators can protect consumers and shippers of natural gas. Yet, FERC and the courts have concluded that FERC's existing refund authority under the Natural Gas Act is severely limited. It is to that aspect of the issue that we address ourselves.

Today refunds can only be ordered where the pipeline seeks a rate increase above that previously authorized by FERC and refunds are limited to the difference between the last clean rate approved by FERC and the increase the pipeline seeks.

As a consequence today, consumers are not adequately protected when the central issue of many rate cases is how much lower, not higher, pipeline rates should be in order to be just and reasonable.

Rates should be lower given lower interest rates and additional depreciation and higher volumes.

In these circumstances, under current law, pipelines have no refund obligation. If the pipeline proposes rates that are equal to those that were previously approved by the Commission, even where it is proven that given lower rates, the newly filed rates should have been significantly lower, there is no refund exposure. That is illogical. It does not make good sense at all.

My bill would remove the refund floor, and by authorizing FERC to order refunds for any amount exceeding what the FERC determines to be the just and reasonable rate under the new circumstances, amendments to the Natural Gas Act are necessary to make full refund rights a reality. Whether a pipeline seeks a rate increase, a decrease, or seeks to continue charging the same rate, refunds should be available for any rate exceeding that rate determined by FERC to be just and reasonable.

On section 5 my bill authorizes refunds from 60 days after a section 5 complaint is filed with the Commission, rather than only prospectively. Because many investigations at FERC take years, during which time consumers are being overcharged, prospective relief is little or no relief at all. This provision is similar to a proconsumer measure enacted into law in 1988 for electricity consumers. I think consumers of natural gas deserve the same protection we gave to electric consumers 3 years ago.

Previously, if the FERC concluded that a particular rate was unjust and unreasonable in a section 5 complaint proceeding, the relief to electricity taxpayers was prospective only. That is, consumers found to have been overcharged would receive relief in the form of lower rates after years of litigation. No refunds were provided.

Under the Regulatory Fairness Act, FERC can order refunds to consumers of amounts collected that the Commission finds to be in excess of just and reasonable levels. Natural gas consumers deserve the same degree of protection afforded electricity consumers.

I know the Chair is tied up with a consultation with a staff member and as long as I have his assurance that he is going to take the ball and run favorably with this bill, I really will not worry too much as to what the staffer is telling him. But I sort of feel like I am at the Yeltsin meeting this morning, where we only were able to talk through the interpreter. And I am not sure that the interpreter in this instance is speaking to the same subject that I am speaking about.

Senator WIRTH. He is speaking to exactly the same subject. I was asking him how long it takes FERC to do a proceeding on this and why do we not make FERC move more rapidly if there is legitimacy to the point that you are making.

I was so impressed with what you had to say that I asked him, why do we not get FERC to operate more rapidly. There are some of us who can talk, listen, and chew gum at the same time, you see. [Laughter.]

Senator METZENBAUM. Let me proceed, with apologies to you, Mr. Chairman. I was just kidding around.

Senator WIRTH. President Yeltsin, you can continue. [Laughter.]

Senator **Metzenbaum**. The third major provision of the bill simply requires by statute what has previously been provided by regulation to ensure that rates reflect current actual cost of providing service. Pipelines should file a rate case at least every 3 years. I think it is an arguable point, but I think it is a reasonable approach to the issue. FERC has been changing its regulations in a manner which eliminates the 3-year filing requirement.

If costs are decreasing and the existing rates are producing significant rates of return, there is no incentive for a pipeline to file a new rate case. It is not unreasonable or burdensome to require a regulated entity to permit the public the opportunity to review its rates every 3 years.

I think that that conceivably could be handled in a reverse way where the Commission would be required every 3 years to review the rates whether or not there had been a filing. I think it is a matter that could be worked out if there was an inclination to do so.

This bill would require a pipeline to file a rate case at least every 3 years to ensure cost-justified, just, and reasonable rates.

In conclusion, Mr. Chairman, my bill is designed to ensure that pipeline rates are just and reasonable and that rates to natural gas consumers are at the lowest possible level consistent with reliable and safe service and a fair profit to the pipelines.

The bill will authorize refunds to consumers of amounts collected that the Commission finds to be in excess of just and reasonable levels. I am not proposing mandated discounts or limitations on pipeline earnings. This bill authorizes refunds. Refunds, only, Mr. Chairman. It will authorize FERC, after FERC determines the just and reasonable rate, to give consumers their own money back.

I am not proposing retroactive refunds. Under my bill, consumers would receive refunds for only those rates filed after the effective date of this bill.

For section 4 rates, those rates initiated by the pipelines, refunds would run from the effective date of the new rates to the date of a FERC decision. For section 5 rates, those instituted after complaint proceeding, refunds would run from a time to be determined by FERC, but would run from between 2 and 5 months after a complaint is filed.

To insure that rates are kept current and cost-justified, I propose the pipelines file their rates for review at least once every 3 years.

I am interested in results, Mr. Chairman. I am interested in achieving the objective of being fair to the consumers. And I do not want to be unfair to the pipelines. To be specific, I want to see that consumers are given increased refund rights.

Simply put, why should pipelines be permitted to keep anything above the just and reasonable rate? I want to ensure that consumers are not forced to pay rates that are any higher than those determined by the FERC to be just and reasonable.

These amendments enjoy widespread support among consumers, local distribution companies, and shippers of natural gas on interstate pipelines. My bill is supported by the National Association of States Utility Consumer Advocates, Citizen Action, and the Consumer Federation of America.

The pipelines themselves are understandably opposed to strengthening refund rates. They want to keep the overcharges that they have collected. But that is wrong. It is not fair. And there is no logic whatsoever in permitting them to keep money that does not legally belong to them and that only stays with them because there are no refund procedures at the moment.

I will be happy to hear from the witnesses at today's hearing. I will not be able to stay for the entire proceeding. My staff member who is very knowledgeable in this area will be here in my stead. I would be interested in constructive suggestions as to statutory language that may better accomplish the results if the language that I proposed is not the best.

My feeling is, Mr. Chairman, that in 1989 I offered a similar measure that offered proposed increased refund rights under section 4 and section 5 of the Natural Gas Act. My bill was offered as an amendment to natural gas legislation then moving through the Senate; 43 of my colleagues supported my amendment at that time.

This year I was pleased to see a major element of my 1988 amendment introduced as a part of the Johnston-Wallop Energy Security bill. However, I was disappointed that the refund provision was dropped. But I believe that its initial inclusion in S. 341 suggests that these measures are gaining increased support. Based on this, I trust that this year we will succeed in giving natural gas consumers some additional protection from overcharges.

I would hope that the record might be kept open subsequent. There may be some consumer groups who wish to submit a statement.

Thank you.

[The prepared statement of Senator Metzenbaum follows:]

Prepared Statement of Hon. Howard M. Metzenbaum, U.S. Senator From Ohio

Mr. Chairman, thank you for holding this hearing on S. 933 so promptly after introduction of the bill. The legislation has one principal objective: to create new refund rights for consumers of natural gas whom the Federal Energy Regulatory Commission (the "FERC") has determined have been overcharged, i.e., consumers who have paid a rate exceeding the rate that FERC determines is "just and reasonable."

The bill does this in three ways:

1. It amends section 4 of the Natural Gas Act—the provision of law under which pipelines seek to make their rates effective by removing the refund "floor" and thereby permitting refunds not only where a pipeline seeks a rate increase as under current law but also where the pipeline seeks to continue collecting the same rate or a reduced rate that FERC determines to be above the "just and reasonable" level.

2. It amends section 5 of the Natural Gas Act—the provision under which the FERC, State commissions, local gas distribution companies and others may file a complaint to review the appropriateness of pipeline rates—to provide for refunds for overcharges beginning 60 days after a successful complaint is filed with FERC. Under current law, relief in the form of reduced rates, is prospective only after a FERC final order—and the pipeline retains overcharges collected for years during the complaint proceeding. This provision would simply give gas consumers similar rights as those afforded electric consumers under the regulatory fairness act which amended section 206 of the Federal Power Act.

3. My bill requires pipelines to file a rate case at least once every three years to ensure that rates reflect actual current costs of service. This provision would require by statute what FERC regulations and regulatory practice provided until recently and would ensure cost-justified rates. Also, some have suggested that increasing refund rights under section 4 will discourage pipelines from filing new rates. A requirement that regulated entities file current cost data at least once every three

years will militate against a failure-to-file. Moreover, such a requirement is not unreasonable or overly burdensome.

These provisions enjoy widespread support among consumers, local distribution companies, and shippers of natural gas on interstate pipelines. My bill is supported by the National Association of State Utility Consumer Advocates, Citizen Action, and the Consumer Federation of America. The pipelines themselves are understandably opposed to strengthening refund rights—they want to keep the overcharges they have collected.

REGULATORY BACKGROUND

Mr. Chairman, since 1938 the natural gas industry has developed and matured under the standards of the Natural Gas Act. A natural gas pipeline operates as a public utility. It provides an essential service. It is a business affected with a public interest. It is granted monopoly or near-monopoly power over essential facilities, pipelines. For these reasons, it is subject to regulation.

Congress instructed the FERC's predecessor agency, the Federal Power Commission (the FPC) in section 4(a) of the Natural Gas Act, to ensure that pipeline rates be "just and reasonable." through administrative and court decisions, we have come to understand that "just and reasonable" pipeline rates should provide pipelines fair compensation for their costs and an opportunity to earn a reasonable return on investment. It is also understood that ratemaking should ensure that rates are nondiscriminatory and should be set at the lowest possible level to consumers consistent with safe and reliable service. My bill does not change this in any way. It merely seeks to ensure that ratepayers should pay no more than the "just and reasonable" rate.

SECTION 4

In the past, section 4 of the Natural Gas Act worked well enough, however, today consumers are not adequately protected. The authority to order refunds is possibly the single most important means by which regulators can protect consumers and shippers of natural gas. Yet, FERC and the courts have concluded that FERC's existing refund authority under the Natural Gas Act is severely limited. Refunds can only be ordered where the pipeline seeks a rate increase above that previously authorized by FERC and refunds are limited to the difference between the "last clean rate" approved by FERC and the increase the pipeline seeks.

Today consumers are not adequately protected when the central issue of many rate cases is how much lower, not higher, pipeline rates should be in order to be just and reasonable. Rates should be lower given lower interest rates, additional depreciation, and higher volumes. In these circumstances, under current law, pipelines have no refund obligation. If the pipeline proposes rates that are equal to those that were previously approved by the Commission—even where it is proven that given lower rates—the newly-filed rates should have been significantly lower, there is no refund exposure.

My bill would authorize FERC to order refunds for any amount exceeding what the FERC determines to be the just and reasonable rate under the new circumstances. Amendments to the National Gas Act are necessary to make full refund rights a reality. Whether a pipeline seeks a rate increase, a decrease, or seeks to continue charging the same rate, refunds should be available for any rate exceeding that rate determined by FERC to be "just and reasonable."

SECTION 5

My bill authorizes refunds from 60 days after a complaint is filed with the Commission, rather than only "prospectively." Because many investigations at FERC take years during which time consumers are being overcharged, "prospective" relief is little or no relief at all. This provision is similar to a pro-consumer measure enacted into law in 1988 for electricity consumers. I think consumers of natural gas deserve the same protection we gave to electric consumers three years ago.

Previously, if the FERC concluded that a particular rate was unjust and unreasonable in a section 5 complaint proceeding, the relief to electricity ratepayers was prospective only. That is, consumers found to have been overcharged would receive relief in the form of lower rates—after years of litigation. No refunds were provided. Under the Regulatory Fairness Act, FERC can order refunds to consumers of amounts collected that the Commission finds to be in excess of just and reasonable levels. Natural gas consumers deserve the same degree of protection afforded electricity consumers.

RATE FILING REQUIREMENT

The third major provision of the bill simply requires by statute what has previously been provided by regulation: to ensure that rates reflect current actual costs of providing service, pipelines should file a rate case at least every three years. FERC has been changing its regulations in a manner which eliminates the three year filing requirement.

If costs are decreasing, and the existing rates are producing significant rates of return, there is no incentive for a pipeline to file a new rate case. It is not unreasonable or burdensome to require a regulated entity to permit the public the opportunity to review its rates every three years.

The bill would require a pipeline to file a rate case at least every three years to ensure cost-justified, just and reasonable rates.

CONCLUSION

Mr. Chairman, my bill is designed to ensure that pipeline rates are just and reasonable and that rates to natural gas consumers are at the lowest possible level consistent with reliable and safe service. The bill will authorize refunds to consumers of amounts collected that the Commission finds to be in excess of just and reasonable levels.

I am not proposing mandated discounts or limitations on pipeline earnings. This bill authorizes refunds Mr. Chairman. It will authorize FERC—after FERC determines the just and reasonable rate—to give consumers their own money back.

I am not proposing retroactive refunds. Under my bill, consumers would receive refunds for only those rates filed after the effective date of this bill.

For section 4 rates—those rates initiated by the pipeline—refunds would run from the effective date of the new rates to the date of a FERC decision. For section 5 rates—those instituted after a complaint proceeding—refunds would run from a time to be determined by FERC but would run from between 2 and 5 months after a complaint is filed. To ensure that rates are kept current and cost-justified, I propose that pipelines file their rates for review at least once every three years.

I am interested in results. To be specific, I want to see that consumers are given increased refund rights. Simply put, why should pipelines be permitted to keep anything above the "just and reasonable" rate? I want to ensure that consumers are not forced to pay rates that are any higher than those determined by the FERC to be "just and reasonable."

I will be happy to hear from the witnesses at today's hearing and from interested parties in the coming days, of helpful, constructive suggestions as to statutory language that might better accomplish these results. If there are concerns with the mandatory refund language in section 5 or the scope of the three year rate filing requirement, I will certainly take those concerns into consideration—as should the committee.

In 1989 I offered a similar measure that proposed increased refund rights under section 4 and section 5 of the Natural Gas Act. My bill was offered as an amendment to natural gas legislation then moving through the Senate. Forty-three of my colleagues supported my amendment at that time. This year I was pleased to see a major element of my 1989 amendment introduced as a part of the Johnston-Wallop energy security bill. I was disappointed that the refund provision was dropped but I believe that its initial inclusion in S. 341 suggests that these measures are gaining increased support. Based on this, I trust that this year we will succeed in giving natural gas consumers some additional protection from overcharges.

Mr. Chairman, I would ask that you keep the record open for the period of two weeks so that additional comments and statements might be received. Thank you Mr. Chairman and members of the committee.

Senator WIRTH. Without objection, it will be left open.

We have been joined by the distinguished Senator from Hawaii. Senator Akaka?

Senator AKAKA. I have no questions.

Senator WIRTH. Senator Nickles, do you have an opening statement?

Senator NICKLES. Mr. Chairman, I will just welcome our panelists. I look forward to hearing their statements on this legislation.

Senator WIRTH. Senator Metzenbaum, thank you very much.

Let me ask you one question. Have you seen, I think there was a release that came out yesterday from Columbia Gas saying that Columbia Gas had today suspended the dividend on its common stock following its board's review of recently completed studies which show that Columbia Transmission's potential exposure under its above-market price gas purchase contracts is substantially larger than previously projected.

Now a concern that I have in terms of energy policy is that what we want to do, at least what I think we want to do, is to, number 1, bring natural gas to markets in the United States which do not have natural gas. If one of our national energy goals is to back out oil, I would think we would want to bring natural gas to more and particularly to those parts of the country that are dependent upon home heating oil.

And second, as we encourage the expansion of natural gas in the United States, that that expansion be American gas where that is feasible and competitive if we want to make it be so.

Both of those kinds of expansions into markets that are now not served by natural gas and into enhanced natural gas markets require that the pipelines be in good financial shape. That is in our national interest to do so.

The argument has been made and I suspect we will hear this from some of our witnesses, that the passage of your legislation will further endanger the already strained conditions in which the industry finds itself.

How do you respond to what would appear to be conflicting goals related to the financial stability of the pipeline industry.

Senator **Metzenbaum**. I share your concern about the economic strength of the pipelines. And I am aware of the fact that we, as a country, want them to be economically viable.

But let us face it. Columbia Gas' report, as I heard you read it, indicates to me that much of their problem relates to the fact that they entered into take or pay contracts some years ago and apparently are still obligated on those contracts. If they made some bad decisions, I am not prepared to fault them. I am not prepared to say that every business person is expected to make a right decision.

What I would argue very strenuously is that because they have an economic problem which results from their own actions is no reason to take it out on the consumers who have overpaid and who are entitled to a refund.

I think that we have a right to consider how we can be helpful. Maybe you come up with the conclusion that they do not have to pay the total refund immediately if FERC decides that are in an economically or financially distressed condition, but are obligated to pay it prior to any time that they issue a dividend. And that the amount will be paid plus some interest factor.

I think something of that kind would be reasonable. I do not want to decimate the natural gas companies. But if I am entitled to a refund from you, the fact that you made a bad deal with Senator Nickles on some other totally unrelated subject should not cause me to have to cover your losses. If you do not have the money to pay me, I am willing for us to provide some language that makes it possible for you to get some additional time to make the refund.

Senator **Wirth**. I hear what you are saying.

As one Senator, I come at it from the perspective of wanting to assure that the pipelines are able to do what I believe is in our national interest to do, which is to expand natural gas into these other markets. And how we can do this without threatening the financial health of those pipelines seems to me is a framework of issues, as you say, it is a legitimate set of issues. Maybe there is a way of doing it.

Senator **Metzenbaum**. Would not the Chair agree that no matter how strong our inclination is to help them expand into other markets or to meet other energy demands, that there is no merit to—there may be merit in saying for future gas everybody has to pay X cents more.

But to say that I have been overcharged and I cannot get my money back because you need the money for some other purpose, that is the only argument I would make. I do not have any quarrel about the desire to help them expand into other areas. But I think they ought to pay their debts first.

And I am willing to say that if they cannot pay their debts with cash, let us let FERC give them some additional time and let them just agree to pay the money 1 year or 2 years or 3 years from now with some modest interest factor included.

Senator **Wirth**. I hear what you are saying.

If you do what your legislation suggests, it seems to me one of the other things that happens is that the pipelines are presumably going to be viewed by the financial markets as institutions that have a potential refund liability. If you are Wall Street looking at financing, or whoever it is looking at financing a pipeline, you say to that pipeline, well, maybe that pipeline has X, Y, and Z liabilities coming down the line.

If, in fact, those liabilities are going to exist for those pipelines that means that the risks of those pipelines increases. That means that the cost of money for those pipelines is going to increase.

And ultimately one of two other things can happen. If that goes up, the cost of doing business with a pipeline is going to go up, which is going to cost the consumer more. That is a very, very real possibility.

Or, if the pipeline becomes engaged in all kinds of liabilities, their cost of business goes up as well, costing the consumers ultimately. I do not what the trade-offs of those analyses might be.

Senator **Metzenbaum**. Mr. Chairman, I want to say that I am not suggesting any retroactive refunds. That is not what I am proposing. I am talking about prospective ones. If you do not overcharge, you do not have to make any refunds.

As far as the effect on the capital market, the capital market is not predicated on you overcharging your customers.

Senator **Wirth**. If it is a current time where this decision occurs, between the time that a pipeline comes in and applies to FERC for an increase, after that 5-month period of time as I understand it, the increase kicks in, is that right, while FERC makes the determination. How long on the average does it take FERC to make that determination?

Senator **Metzenbaum**. Sometimes years.

Senator **Wirth**. Do you not solve the problem by saying the increase does not go in until the determination is made and giving

FERC a time certain to come to agreement, a time certain to make a decision?

Senator METZENBAUM. That is another way of doing it. The House bill does that. And that would be an acceptable procedure also, because that would protect the consumer.

I do not want anything for the consumer other than the right not to be overcharged. It just seems to me that we in Congress ought to make every effort possible to do that without, at the same time, doing any harm to the industry.

Senator WIRTH. We have also been joined by the distinguished junior Senator from Alabama, Senator Shelby.

Senator SHELBY. Are you giving me a little time now, Mr. Chairman?

Senator WIRTH. I will give you as much time as you want, Senator Shelby.

Senator SHELBY. Well, I welcome the Senator from Ohio to the Energy committee. I think we all basically do not want the consumer overcharged on anything, and we are all consumers in America, ultimately. And the Senator from Ohio knows this, and he has been a great advocate over the years on behalf of the consumers of America and the working people of America.

In my State of Alabama, we both produce and consume large quantities of natural gas. I do not know how much gas you produce in Ohio, but I know you consume a lot. You do some of both.

Senator METZENBAUM. We produce.

Senator SHELBY. I have not gotten to study the implications of the bill, but one of the big bargains has been in America, as far as energy bargains both ways in recent years, has been basically the low price, which really makes a lot of the big gas carriers nervous. It would me because of the price of the gas being low. But it has been a bonanza for the consumers—my State, yours, and everywhere else, relative to the price of other energy.

And the environmental pluses of natural gas that the distinguished Senator from Ohio knows very well. But none of us, the Senator from Ohio aptly states, joined by the chairman from Colorado, none of us want to be overcharged in any way. But it looks to me like the FERC now has a lot of ability. I know it takes many months, many, many moons, I guess, to reach decisions, and the courts have been into this before.

So I would like to ask the distinguished Senator from Ohio, what specifically will your bill do that the courts or the FERC before that could not do now?

Mr. RYNNE. Well, Senator, as Senator Metzenbaum said earlier, it will increase refund rights under section 4 of the Natural Gas Act to expand those rights in the situations where pipelines seek rate increases to include situations where pipelines seek the same rate or a slightly reduced rate, however, where the Commission later determines the rate should have been significantly less. It would also amend section 5 of the Natural Gas Act to include refund rights similar to those which this committee and the Congress approved for section 206 of the Federal Power Act a few years ago.

Senator METZENBAUM. All we are asking for, Senator, is the right to order the refunds. And in cases where they are not seeking a rate increase, they do not have that authority now. And we are not asking for 1 cent more than the amount of the overcharge. And so, no matter how strongly we feel about the rights and the value of the natural gas industry, I think none of us can think that any industry, whether it is natural gas or tomatoes or growing onions, whatever, that anybody ought to be protected by law if they make overcharges, and the consumer ought to be able to get his or her money back.

Senator **Shelby**. I would totally agree with you. We do not want to protect any industry. We want to protect the people. But we need an environment, do we not, Senator, that is fair not only to the consumer, which we all are, and also to people or companies that are in the marketplace where they have predictability there.

Senator **Metzenbaum**. My friend is right. But I want to say that I do not get into the basic issue of what the rate should be charged. I do not get into what the rate of return ought to be. All I get into is the right of the consumer to get a refund to which the consumer is entitled, but now has no procedure to obtain it.

There is no procedure right now when the consumer is overcharged. The consumer has no legal remedy in order to get back the amount of the overcharge. And all I am asking for is a procedure so that he or she can get that. And I do not see how anybody can be opposed to that. I am sort of curious—I wish I could stay but I have another meeting—but to find out why gas producers or gas pipelines would be opposed to giving refunds to people to who are entitled to it.

That is what I do not understand why anybody would be opposed to this legislation. It just so happens legislatively we have not corrected the problem in the past. The bill that started in this committee would have corrected it. When it came out of committee, it did not have that portion in it.

Senator **Shelby**. But your proposed legislation, if it were to become law, of course, would only trigger in the event there was a determination for refund.

Senator **Metzenbaum**. Absolutely.

Senator **Shelby**. Mr. Chairman, I appreciate your indulgence.

Senator **Wirth**. Thank you very much, Senator Shelby.

I think Senator Nickles had a comment that he wanted to make and then Senator Domenici had a question he wanted to ask.

Senator **Nickles**. Mr. Chairman, in follow up with the Senator, I think we could solve maybe a lot of the problem if we put some language, or directed FERC to act as expeditiously as possible, and maybe give them a time frame to do so, whether it be on complaints, rate increases, or whatever, there is a legitimate complaint and some of these cases taking years. I have some reservations about the Senator's amendment that would go back on refunds and so on and what that would do to the markets and what that would do to the health of pipelines and to the industry as well.

But maybe if we moved in an expeditious manner, we could solve some of what the Senator from Ohio is trying to do and get some better cooperation out of FERC. Because you have got a lot of companies and a lot of people that are involved in those cases. And maybe we could work along that line. And I appreciate the Senator's interest. I just do not quite agree with is solution in S. 933.

Senator METZENBAUM. I appreciate the comments of my friend from Oklahoma, who I know is far more knowledgeable than I on natural gas issues. I would very much welcome his assistance in trying to bring about appropriate language to resolve the dilemma and the frustration of the consumer. And I think it can be done without doing any harm to the natural gas pipeline companies.

Senator WIRTH. Senator Domenici.

Senator DOMENICI. Well, Mr. Chairman, I came just for a moment to suggest the very thing that my friend from Oklahoma suggested. It seems to me in just reading a bit about this that many of these cases last a very long time. And in those cases, the longer the time, the more upset the consumer groups get because it could be 3 years, 4 years, 5 years, and that accumulates a very, very large backlog.

It seems like since we are doing a lot of streamlining of FERC with reference to pipeline construction and the like, it might be appropriate to, as Senator Nickles indicated, to put some mandates in the bill with reference to hearing these kind of cases, and maybe as the Senator from Oklahoma suggests, even a deadline: it cannot take any longer than such and such—which would not totally satisfy the Senator from Ohio, but in a sense, if the time frame was shorter, it would satisfy the Senator.

If you made it short enough, it could make it almost a victory for his cause.

Senator METZENBAUM. The Senator from Ohio would be very receptive to the staff, Senator Nickles, Senator Domenici, the chairman. Senator Shelby, if you sit down with my staff and we can work this out, I do not need a piece of legislation. I would just be very happy if we can work it out in some amendment that we can put into effect. I am not anxious to have a bill if we can solve it some other way. But I think we do need some legislation. But I certainly would like very much to work it out with the Senator from Oklahoma, who really is an expert in this area, and the Senator from New Mexico, as well as the Chair, of course.

Senator WIRTH. Senator Metzenbaum, I appreciate your raising this issue. I had suggested earlier that maybe we ought to have this kind of requirement in there for FERC. Senator Nickles picked that same thing up. Senator Domenici has picked that up, and it would appear maybe we ought to be asking FERC what such a requirement would do to their own priorities. I would think that it is a reasonable question to ask FERC this kind of requirement to act within a certain period of time, what would that do to all of the other things you have to do at FERC? And would this be something you could carry out?

Senator SHELBY. Mr. Chairman, I have one last question, if you would indulge.

Senator Metzenbaum, would your legislation tend to create some uncertainty in the industry or consequently then in the marketplace because you need predictability? In any industry, if you are borrowing large sums of money, you know as to what you are going to, as far as your capital outlay, and so forth. And also, I think, the consumer needs some predictability. And I just wondered if this legislation would promote rate uncertainty which would consequently flow into maybe some uncertainty into the industry. I do not know that.

Senator METZENBAUM. I think the Senator from Alabama raises a good question. And that is, yes, there would be some element of uncertainly. But the pipeline company itself would know better than anybody what the proper amount of the over charge has been. They certainly could show that as a reserve on their financial statement, a reserve for potential claims, whatever the case may be. But I think that even though there is some uncertainty, it is not a good enough reason to deprive the consumer of money that he or she does not owe. And that is really all we are saying.

Senator SHELBY. I am not advancing that argument, the other argument. I was just raising the question that I think is central.

Senator METZENBAUM. The Senator from Alabama has been very solid on many consumer issues on the floor of the Senate, and I appreciate that fact. And I have worked with him. So I know that you would not be here wanting to deprive the consumer of anything. I think that if we put our shoulder to the wheel and agree to move forward, I think we can achieve the objective without doing any harm to the industry.

Senator SHELBY. Well, we have got a lot of industries because of LBO's and everything else that you have been involved in and even visited with us in the Banking Committee dealing with securities. That has created a lot of uncertainty in American business today. And we do not need any more of that. That is why I ask the question here.

Senator METZENBAUM. Thank you.

Senator WIRTH. Thank you very much, Senator Metzenbaum. We are delighted to have you here.

Senator METZENBAUM. Thank you, Mr. Chairman.

Senator WIRTH. As I suggested earlier, we would like to have the two panels join us at the table right now. If they would all do so, I would appreciate that.

Mr. Mark Schroeder, the Deputy General Counsel of the Department of Energy; Mr. Kevin Madden, Director of the Office of Pipeline and Producer Regulation of the FERC; Mr. Ron Fuller, vice president, Governmental and Regulatory Services, San Diego Gas & Electric Co.; Mr. John Olson, vice president, Goldman, Sachs; Mr. Ron Kuehn, chairman and CEO of Sonat; and Ms. Margaret Samuels, the Federal counsel for the Ohio Consumer Counsel.

Thank you all very much for joining us. We have had already an extensive discussion of this issue and I think you all have heard this discussion.

And maybe what we might to do to expedite the process here would be to include your statements in full in the record and ask each of you to comment on what you have heard so far. Is this a reasonable approach to this or not? We have heard Senator Metzenbaum's proposal and you have heard the reaction of four Members of the committee to the proposal, looking at perhaps a requirement of an expedited procedure at FERC.

One, is that reasonable? Does that solve the problem? And I guess the previous question is is there a problem, and if there is a problem, does having an expedited procedure solve the problem?

Is that the issue in front of us, Mr. Schroeder? You might start. And maybe we can just run down here and ask each of you to comment on that and move as rapidly as possible.

STATEMENT OF MARK C. SCHROEDER, DEPUTY GENERAL COUNSEL, DEPARTMENT OF ENERGY

Mr. SCHROEDER. I am not sure there is a problem, first of all. But to the extent there is a perceived problem, and as evidenced by Senator Metzenbaum's bill, in terms of the timeliness of FERC proceedings, that is something the subcommittee and the full committee have, over the past several years, urged FERC to address—to deal with cases as expeditiously as possible. I know that that has been one of the Commission's highest priorities. FERC Chairman Martin Allday, General Counsel Bill Scherman, and Kevin Madden, to my right, have all worked very hard to expedite Commission proceedings. I do not believe that there is a problem that needs a fix.

S. 933 is going to create more problems than it will ostensibly solve. It is going to create uncertainty and instability in an industry that currently has a need for revenue and rate certainty. I think this instability is going to be reflected in higher debt and finance costs. These costs are ultimately going to be borne by the consumers. I think Senator Metzenbaum's proposal is very narrow in its approach to solving and protecting the consumer from higher costs.

We are also concerned that if this sort of rate and revenue uncertainty and instability were to become law, or these were the consequences of S. 933, that this would inhibit additional construction and competition, which the Department of Energy and the administration have supported and which this subcommittee and the full committee supported when they marked up and voted out what is now S. 1220. We think the consumer ultimately benefits from this sort of competition and additional construction. And to the extent S. 933 inhibits that, we think again, ultimately, it is the consumer that is the loser.

I also want to point out, and I know Mr. Madden's testimony and prepared statement goes into it as well, that there are very few similarities between S. 933 and the Regulatory Fairness Act passed 2 years ago. The differences are far more numerous than the similarities between that revision to the Federal Power Act, and what is proposed here under the Natural Gas Act. First of all, the Regulatory Fairness Act only amended section 206 of the Federal Power Act, not section 205, which would be the corollary to section 4 of the Natural Gas Act.

Secondly, when section 206 of the Federal Power Act was amended, it provided that the refund requirement was discretionary with the Commission. The amendment to section 5 of the Natural Gas Act proposed by Senator Metzenbaum would make refunds mandatory. And finally, both my testimony and Mr. Madden's prepared statement point out that the section 5 amendment does not appear to limit the refund period, or the amount of the refund liability, in a section 5 proceeding initiated upon the Commission's own motion. These are fundamental and significant differences between that which was enacted when the Regulatory Fairness Act amended the Federal Power Act and S. 933.

That may be more information than the question called for, but I wanted to make each of those points with respect to S. 933.

[The prepared statement of Mr. Schroeder follows:]

PREPARED STATEMENT OF MARK C. SCHROEDER, DEPUTY GENERAL COUNSEL, DEPARTMENT OF ENERGY

I. INTRODUCTION

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to be with you today to discuss the Administration's views on S. 933, introduced by Senator Metzenbaum, which would amend sections 4 and 5 of the Natural Gas Act ("NGA") as they relate to the provision of refunds in interstate pipeline rate proceedings before the Federal Energy Regulatory Commission ("FERC" or "Commission").

The Administration opposes enactment of S. 933. We believe the Natural Gas Act in general reflects an appropriate balancing of the consumer's interest in paying rates which are just and reasonable and the pipeline industry's need for rate stability sufficient to allow for prudent business operations. Nearly every change S. 933 would make to the NGA would vitiate this balance.

II. OVERVIEW OF RELEVANT NATURAL GAS ACT PROVISIONS

Section 4 of the NGA provides the procedures that natural gas companies (for all practical purposes here, "natural gas companies" refers to "interstate pipelines") must follow when filing to change their rates. Generally, a natural gas company must give 30 days notice by a public filing in order to change its rates. Pending a hearing upon the lawfulness of the filing, the Commission may suspend collection of the new rates for a period of up to five months beyond when they would otherwise have gone into effect. After the suspension period, or, if no suspension period is ordered, then at the time requested in its filing, the natural gas company may begin to collect the new rates.

If the new rate placed into effect is an increase, then the difference between the last rate approved by the Commission and the new rate is the amount which is subject to refund. If, at the end of the rate proceeding, the natural gas company has not sustained its burden of proving the increased rate to be just and reasonable, the Commission may order the company to refund, with interest, to its customers that portion of its increased rates which the Commission found not to be justified. However, in a Section 4 proceeding initiated by a natural gas company, the Commission may not set a new rate below the previously established just and reasonable rate. Likewise, it may not order the company to refund amounts collected beyond the rates which it has previously approved since the burden is only upon the company to justify its increase, not its total rate structure. This is known as the "last clean rate" doctrine.

If the new rate sought by the natural gas company in its filing is a decrease from the previously approved rate, no amount is made subject to refund.

Section 5 of the Natural Gas Act provides that the Commission, after a hearing had upon its own motion or upon complaint, may determine that a rate or charge being collected for transportation or sale is unjust, unreasonable, unduly discriminatory or preferential. If the Commission makes this finding, it is then required to determine the just and reasonable rate to be thereafter collected. Since the Commission is required to find that a rate it has previously approved is no longer just and reasonable, the burden to establish a new just and reasonable rate, to be applied prospectively, is upon the Commission. Thus, the rates collected after the filing of the complaint, but before the establishment of a new just and reasonable rate, are not subject to refund.

III. S. 933'S PROPOSED AMENDMENTS TO THE NATURAL GAS ACT

Section 2(a) of S. 933 would amend section 4(e) of the NGA to affect two material changes. First, when a rate increase is sought, the Commission could order refunds in amounts greater than the difference between the rate increase sought and the last approved just and reasonable rate. That is, notwithstanding the fact that a natural gas company sought a rate increase, if the Commission ultimately approved as the just and reasonable rate a rate lower than the last approved rate, the natural gas company would not only have to refund the amounts collected in the proposed increase, but also the difference between the last approved rate and the now lower, approved just and reasonable rate.

In addition, under section 2(a) of S. 933, if the natural gas company files for a rate decrease, and the Commission ultimately orders a lower rate than the one sought by the company, then the company would have an obligation to refund the difference between the amount it collected and the amount ultimately found to be just and reasonable.

If this change to NGA section 4(e) were adopted, it would have several deleterious consequences. First, with the filing of each section 4 rate proceeding by a natural gas company, the company exposes itself to an unquantifiable refund liability. This unquantifiable liability may remain unresolved, and continue to grow, for a period of years—until the rate proceeding concludes. These accruing liabilities could create a morass of problems as these companies attempt to comply with other statutory obligations regarding full public disclosure to the investor community. Even assuming that some form of appropriate disclosure can be reached, it will remain, at best, uncertain and less quantifiable than refund liabilities under the present NGA. Pipelines will not only be required to justify any increase in rates, but will be given the burden of proving that rates previously approved by the Commission remain just and reasonable. The interstate pipelines, and, ultimately, their customers, will pay the price for this, as uncertainty is perceived as risk in the capital markets, and added risk carries with it additional financing costs.

In addition, this amendment would deprive the pipeline industry of the rate stability necessary for prudent business operations. If pipelines may be required to refund amounts based upon rates which have previously been found to be just and reasonable, the stability and predictability necessary to make reasoned business decisions and to induce new capital investment in facility modernization and expansion will be lacking. This is counterproductive to the objectives which the Administration's National Energy Strategy and the National Energy Security Act, S. 1220, reported by the Senate Energy and Natural Resources Committee, seek to achieve.

Finally, exposing pipelines to this unlimited liability even when rate decreases are sought will only discourage pipelines from making such filings. Instead, they will have the incentive not to file, leaving it to the Commission or other complainants, who then also are given by statute the burden of proof, to seek lower rates. The National Energy Strategy recommended elimination, not creation, of regulation that promotes rigidity and lack of market responsiveness in the natural gas industry.

Section 2(b) of S. 933 would require each natural gas company to file new rates every three years. The Commission presently requires such a filing under certain circumstances, in particular, when the interstate pipelines avail themselves of Purchased Gas Adjustment clauses as provided for under the Commission's regulations. Thus, the Commission, under appropriate circumstances, has authority and can achieve the objectives of section 2(b) of S. 933.

Further, we see no need for creating such an arbitrary and costly statutory requirement. Rate proceedings are extremely expensive, and these costs are borne by consumers and shippers. To the extent a rate filing is not necessary or warranted, this proposal nevertheless would require that these added costs be incurred. Natural gas pipelines are operating in increasingly competitive markets. This competition usually provides the incentive for pipelines to modify their rates to remain competitive. Where competition is not a sufficient incentive, the NGA provides a separate and adequate remedy under section 5. Rather than attempting to micro-manage utility regulation, or put in place rigid statutory requirements, the Administration believes it is better to leave the establishment of appropriate practices and procedures to the discretion of the FERC.

Section 2(c) of S. 933 would amend the section 5 complaint procedures to provide that rates determined in such proceedings become effective prospectively from a "refund effective date," rather than prospectively from the conclusion of the proceeding. This amendment establishes no outer limitation on the "refund effective date" which may be set by the Commission when it initiates a section 5 proceeding on its own motion. Thus, it creates open-ended and unquantifiable refund liabilities similar to, and perhaps even greater than, those which were noted as objectionable in my discussion of the proposed amendments to NGA section 4. Furthermore, it eliminates the burden which the Commission has of determining that its previously approved rates are no longer just and reasonable before it establishes new rates.

Finally, section 2(e) of S. 933 proposes a study by the Commission of the effects of S. 933's amendments, if adopted, on the natural gas industry. Given the Administration's opposition to S. 933's substantive changes to the NGA, we view such a study as unnecessary and oppose it.

IV. CONCLUSION

Mr. Chairman, the Administration strongly opposes S. 933. It would impose additional costs on the natural gas industry and consumers, and would create uncertainty and investment risk which will operate as a disincentive to new capital investment and more competitive operation, contrary to the best interests of all those affected by the natural gas industry, including consumers.

I would be pleased to respond to any questions which you or other Subcommittee members may have.

Senator **WIRTH**. Thank you very much, Mr. Schroeder.

I think a lot of the material was in the record, and if we could respond to the double question. I appreciate what you are saying, Mr. Schroeder, but respond to the double question. One, is there a problem? And second, does expedited procedure solve the problem? I know there are things that we have not talked about that ought to be.

Mr. Madden.

STATEMENT OF KEVIN P. MADDEN, DIRECTOR, OFFICE OF PIPELINE AND PRODUCER REGULATION, FEDERAL ENERGY REGULATORY COMMISSION

Mr. **MADDEN**. Mr. Chairman, let me see if I can provide the subcommittee with my thoughts entirely on the package.

Senator **WIRTH**. That is what you are here for, Mr. Madden.

[The prepared statement of Mr. Madden follows:]

PREPARED STATEMENT OF KEVIN P. MADDEN, DIRECTOR, OFFICE OF PIPELINE AND PRODUCER REGULATION, FEDERAL ENERGY REGULATORY COMMISSION

Mr. Chairman and members of the subcommittee, my name is Kevin P. Madden. I am Director of the Office of Pipeline and Producer Regulation of the Federal Energy Regulatory Commission. I appear today as a staff witness and do not speak on behalf of the Commission. I appreciate this opportunity to discuss how the provisions of Senator Metzenbaum's Natural Gas Ratepayers Relief Act of 1991 (S. 933) would affect the Commission's regulation of the natural gas industry.

Before I address the specific provisions of S. 933, I would like to briefly describe the current statutory scheme and procedures embodied in the Natural Gas Act of 1938, as amended (NGA). I will then present a brief description of how the provisions of S. 933 would change the current process, followed by a section by section analysis of the provisions of this bill.

CURRENT LAW

Sections 4 and 5 of the NGA address the rates an interstate natural gas pipeline may charge its customers. Section 4 governs the way a natural gas company may file changes to its tariffs or rates. As a general matter, section 4 requires that rates be just and reasonable. Section 5 permits the Commission, upon complaint, or on its own motion, to order reductions of rates or tariff changes on a prospective basis if it finds that the rates in place are no longer just and reasonable.

Section 4 is composed of several subsections. First, section 4(a) requires that all rules, rates and charges of a natural gas company for services subject to the Commission's jurisdiction be just and reasonable. Section 4(b) prohibits undue preference or discrimination. Section 4(c) requires natural gas companies to file tariffs with the Commission stating their rates, and all classifications, practices, regulations, and contracts affecting these rates. Section 4(d) requires a 30-day notice to the Commission and to the public of any proposed rate change, except where the Commission waives the notice period for good cause shown. Section 4(e) empowers the Commission to suspend the effective date of a tariff filing for a period of up to five months to conduct a hearing into the lawfulness of the tariff filing. As a general matter rates go into effect at the end of the suspension period subject to the pipeline re-funding any increase above its existing just and reasonable rate that the Commission may subsequently find to be unjust and unreasonable.

This is accomplished through section 4(e), which puts the pipeline on notice that if the Commission, after a rate hearing, finds that the pipeline did not prove that the increased rates are justified, the Commission may order refunds, plus interest, of the overcharges. Under the statute, the burden of proof to show that a rate increase is just and reasonable rests with the pipeline. Finally, Section 4(e) requires the Commission to give preference to rate proceedings over other pending questions, and to decide the lawfulness of the proposed rate increase as speedily as possible. Under section 4, the Commission normally orders refunds if rates are found to be too high and thus unjust and unreasonable. However, there are occasions when the Commission, in its discretion, determines that refunds would not be appropriate.

Section 5(a) of the NGA authorizes the Commission, upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, to modify prospectively currently effective rates if it determines at a hearing that existing rates are unjust and unreasonable, or unduly discriminatory or preferential. Under section 5(a) the Commission may not order an increase in rates; nor may it order a reduction in rates retroactively.

THE NATURAL GAS RATEPAYERS RELIEF ACT OF 1991

The Natural Gas Ratepayers Relief Act of 1991, introduced by Senator Metzenbaum as S. 933, proposes several significant amendments to sections 4 and 5 of the NGA. First, section 2(a) of S. 933 amends the third and fourth sentences of section 4(e) of the NGA by deleting the limitation on the Commission's suspension and refund authority for rate increases only. Thus, all rate changes would be subject to refund. Second, section 2(b) of S. 933 adds a new provision to the NGA—section 4(f)—that requires all jurisdiction pipelines to file a rate case at least once every 36 months so the Commission can investigate all elements of a pipeline's rates.

Third, section 2(c) of S. 933 amends section 5 of the NGA. It would require the Commission to order refunds, plus interest, for any amounts determined to be in excess of just and reasonable rates. The bill directs the Commission to establish a refund effective date for any refunds that might be ordered after a hearing. The refund effective date must be at least 60 days after the filing of a valid complaint alleging that the last approved rates are no longer just and reasonable, and no more than 150 days after the end of the 60-day period.

Fourth, section 2(d) of S. 933 provides that amendments to section 5 would not apply to section 5 proceedings commenced prior to the effective date of the Act, but that any pending complaint may be withdrawn and refiled without prejudice.

S. 933 also includes a provision requiring the Commission to perform a study of the effects of these amendments within three to four years of enactment.

SECTION BY SECTION ANALYSIS

Proposed Modifications to NGA Section 4

Section 2(a) of S. 933 proposes to modify NGA section 4(e), to allow the Commission to order refunds of any amounts found to be in excess of just and reasonable rates. Under current practice, refunds are limited by a refund floor set by the last just and reasonable rate set by the Commission. This practice follows the guidance of the courts on the refund authority granted by section 4(e). E.g., *FPC* v. *Sunray DX Oil Company*, 391 U.S. 9 (1969); *Distrigas of Massachusetts Corp.* v. *FERC*, 737 F.2d 1208 (1st Cir. 1984); and *Florida Gas Transmission Co.* v. *FERC*, 741 F.2d 1307 (11th Cir. 1984). Thus, refunds have been limited to only those amounts of the proposed increase in rate; although rates may be reduced prospectively.

Presently, Commission regulations require pipelines with purchased gas adjustment mechanisms to file a restatement of their rates at least once every three years. In cases where the pipeline proposes a decrease in its tariff, or merely files a restatement supporting continuation of the last just and reasonable tariff, the Commission does not have the authority to order refunds, but it may reduce rates on a prospective basis. Providing for refunds in these cases is one of the stated goals of S. 933. In general, this change may provide a stronger motivation for pipelines to settle rate cases, rather than see potential refund liabilities mount during lengthy litigation. However, there are also some offsetting concerns which should be given consideration.

In some rate cases, changes in cost allocation, rate design, and other factors may result in increased rates for some services and decreased rates for others, even when the pipeline's revenue requirement does not increase overall. This has become more common over the last few years as pipelines seek to restructure services to serve increasingly competitive markets. A pipeline may propose to change its cost allocation or rate design in a section 4 proceeding. If the Commission finds the changes to be unreasonable, it may order retroactive decreases (refunds) to the customers adversely affected by the changes. However, the pipeline may not offset the decreases with retroactive increases (or surcharges) for those customers that benefited from the proposed changes. See *FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145, 152-153 (1962).

Also, a utility's financial viability and ability to serve its customers could be jeopardized if large refunds were ordered. Thus, a pipeline may be presented in its rate case with a potentially unknown refund obligation. During the pendency of each rate case, the uncertainty—alone—of the pipeline's minimum revenue stream could increase the cost of obtaining new capital, or make it difficult to fund needed new construction. And, potential financial uncertainty mounts with the time required in each case. The Committee may wish to consider the potential impact, on balance, of this proposed change.

Section 2(a) of S. 933 also proposes to place the burden of proof "to show that the changed rate or charge is just and reasonable" on the pipeline in cases filed under NGA section 4(e). The proposed section 2(a) appears to place the burden on the pipeline of justifying all aspects of its rates in either rate increases or decreases. Section 2(a) is silent on whether the burden rests with the pipeline when it makes a rate filing, such as a restatement, where the pipeline proposes neither an increase nor a decrease.

Section 2(b) of S. 933 would amend the NGA by adding a new section 4(f). Section 4(f) would require every jurisdictional pipeline company to file to establish new base tariff rates every three years. In light of the more competitive environment, the trend in service restructuring among pipelines is moving from the use of PGA-based sales tariffs. For example, in recent orders the Commission has authorized pipelines to abandon their PGA and make future sales for resale, on a freely negotiated basis. Over time this will result in fewer pipelines being subject to the three-year rate review required by the Commission's PGA regulations. To the extent proposed NGA section 4(f) would mandate triennial review of base tariff rates including market-based negotiated sales rates, it may block further progress toward the effective operation of a competitive marketplace for natural gas.

Finally, the Committee may wish to examine the utility of requiring a rate filing for every pipeline every three years. Not every pipeline has the same potential for significant rate impact. Today, 44 of the over 130 interstate pipelines deliver more than 80 percent of the natural gas sold or transported in interstate commerce. The remaining pipelines are generally much smaller, both in terms of volumes of service delivered and in terms of potential dollar impact. Currently, only 45 pipeline companies are subject to the Commission's PGA regulations, and are therefore required to file triennial restatements. The proposed legislation, if it is applied to all pipelines, would cover more than three times the number of pipelines currently subject to the Commission's three-year filing requirement. A uniform filing requirement could result in too many resources both the industry's and the Commission's—being spent examining many smaller pipelines, while diverting resources away from major pipeline rate filings. Commission review of annual reports, and customers' complaints may provide an adequate level of protection for customers of smaller pipelines, without a mandatory three year review requirement applying to all interstate pipelines.

Proposed Modifications to NGA Section 5

Section 2(c) of S. 933 would amend NGA section 5, to require the Commission to order refunds of charges found to be excessive. The Commission would be required to establish a refund effective date no earlier than 60 days after a complaint is filed and no later than 150 days after expiration of the 60 day period. Once the Commission had determined the just and reasonable rate that should have been charged, it must order refunds. Several areas of this provision warrant clarification.

First, section 2(c) of S. 933 proposes to add a new NGA section 5(b) which states, in part, that:

> . . . The Commission shall establish the refund effective date. In the case of a hearing instituted on complaint, the refund effective date shall not be earlier than the date that is 60 days after the date of filing of the complaint or later than 150 days after the expiration of such 60-day period.

This language could be read as allowing the Commission unlimited discretion in setting a refund effective date for an NGA section 5 proceeding, instituted upon its own motion. Most stand alone section 5 cases are instituted by the Commission upon its own motion. This is in contrast to the provisions of the Regulatory Fairness Act amendments to the Federal Power Act, which provided that, where the Commission institutes a complaint proceeding, the refund effective date follows the same time interval restrictions after publication of the notice instituting the proceeding.

Second, the proposed modification to NGA section 5(b) would state that "the Commission shall order" refunds. This compares to the language found in NGA section 4(e), which states that "the Commission may, by order, require" refunds. The difference is significant. As I noted in my earlier comments on the proposal to remove the refund floor under NGA section 4(e), there may be circumstances where the Commission decides, for equitable reasons, not to order refunds for past periods. These equitable considerations may include the pipeline's financial circumstances, and potential revenue deficiencies due to cost shifting among services. As currently worded, the Commission would be required to order refunds, regardless of the circumstances. Moreover, section 2(c) of S. 933 requires the Commission to order refunds in all section 5 proceedings. In contrast, the Regulatory Fairness Act made this analogous refund authority discretionary. Permissive authority rather than mandatory requirement would be preferable, because there are occasions where refunds would be inequitable or may not be in the public interest.

Third, there is also a concern that refund provisions may lead to frivolous complaints. The Committee may wish to make clear that it does not intend to change the threshold burden attendant on a complainant to support an allegation that a pipeline's rates are unjust and unreasonable. In implementing its responsibilities under the NGA the Commission would continue to require a complainant to demonstrate specific bona fide concerns before instituting a complaint proceeding under section 5. Pipelines will still have considerable protection in section 5 proceedings under S. 933 because it does not change the existing requirement that the Commission must first find the existing rate to be unjust and unreasonable and then determine what the just and reasonable rate should be. This is a serious undertaking for parties arguing that the pipeline's rates are unreasonable and should tend to discourage frivolous complaints.

Further, making section 5 cases subject to refund prospectively, from an effective date the Commission would establish at least 60 days after the parties have been notified of an investigation, would appear to make section 5 proceedings similar, but not identical, to section 206 of the Federal Power Act, as amended. Prior to passage of the Regulatory Fairness Act, the courts, the Commission, and parties could rely upon the case law precedent in NGA section 5 cases in evaluating section 206 filings, and visa-versa. The Supreme Court has stated that section 206 of the Federal Power Act (FPA) and section 5 of the NGA are substantially identical, and therefore constructions of one were authoritative for the other. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981). However, the D.C. Circuit refused to construe a recent section 5 case based on FPA section 206 precedent since the adoption of the Regulatory Fairness Act. That court stated: "This amendment, [the Regulatory Fairness Act] designed to overcome the disincentive facing electric utilities to speed and settle section 206 cases, introduces a significant difference in the regulatory approaches of the Natural Gas Act and the Power Act. Our discussion here, then must be understood to apply only to the Natural Gas Act." *East Tennessee Natural Gas Co.* v. *FERC*, 863 F.2d 932 (D.C. Cir. 1988).

When Congress amended the FPA in 1988 to provide refunds of overcollections during the pendency of rate reduction cases, it placed a 15 month limitation on potential refund liability of the electric utility. This limitation appears to have been added to prevent customers from delaying the conclusion of a rate decrease case, using the mounting refund liabilities as leverage against the utility. The Regulatory Fairness Act provided, however, that the utility could be held responsible for refunds beyond the 15 month period if the Commission determined at the conclusion of a longer proceeding that it was not resolved earlier due primarily to the dilatory behavior of the utility.

The Committee may want to consider adding this provision to S. 933 to bring section 5 of the NGA in line with the current refund limitation in the Federal Power Act. Such a provision would limit any perceived uncertainty concerning the potential refunds which may be required of a pipeline.

The Commission Would Be Required To Submit A Study

S. 933 also includes a provision requiring the Commission to perform a study of the effects of these amendments within three to four years of enactment. This study is virtually identical to the one the Commission must undertake for Congress concerning similar changes Congress adopted in Regulatory Fairness Act. The Commission study must analyze: (1) the impact on the cost of capital paid by natural gas companies; (2) any change in the average time taken to resolve proceedings under sections 4 and 5 of the NGA; and (3) other matters the Commission may deem appropriate in the public interest. I do not foresee any difficulty in the timely completion of this study should the Committee find it appropriate.

CONCLUSION

I will now be happy to answer any question the subcommittee may have.

Mr. MADDEN. In terms of the first question, as to whether or not there can be some expedition in the processing of section 4 or section 5 cases, let me give you some figures. Since fiscal year 1988, the Commission receives approximately 25 rate cases annually. Now those rate cases could be decreases, increases, or restatements. And restatements are essentially where the pipeline would restate their rates.

Senator WIRTH. Since 1988, you have had 25 rate cases.

Mr. MADDEN. Each year. Filed each year. Of those that have been filed to date, 83 percent of those cases have been resolved through settlement process. And they have been acted on, in general, in 18 months.

Now, they are filed under section 4, and under section 4, the rates are suspended up until 5 months, at which point the new rates go into effect. In most of those settlements, when the parties settle the case, they settle the case in terms of the overall rate allocation back to the beginning of the fifth month. So that the consumers indeed are benefited.

Now, as to those remaining cases that are not settled, that actually go through the litigation process before an ALJ, discovery—initial decision and briefing, and then before the Commission, it takes an average of 45 months.

Now, when you average all those cases together, we have approximately on average 26 months to do a rate case.

Senator WIRTH. What do you do for 45 months? I understand the lawyers' clocks are running during that 45-month period, what else happens?

Mr. MADDEN. Well, I try to be a technical advisor. But what you have in gas cases is numerous parties, unlike what I think——

Senator WIRTH. Numerous parties are there month 1 as well as month 45.

Mr. MADDEN. You may have 100 parties in 1 rate case.

Senator DOMENICI. Mr. Chairman, could I ask a clarifying question? Is there not a difference between a rate case and a complaint case? You are talking about rate cases; we are talking about complaints.

Mr. MADDEN. I think Senator Metzenbaum was talking about both. As to section 5 cases, which are complaint cases, the Commission has received within the past 3 years, stand-alone cases, just section 5, three of them. And they have been resolved through settlement in two cases in 7 months, and in one case in 11 months. Now, those are section 5 cases.

Senator WIRTH. So you have section 4 cases are rate cases, and you have 25 a year. And of those, 75 percent are settled, so we are talking about six cases a year that creates this problem. And then you have had three section 5 cases since 1988.

Mr. MADDEN. Stand-alone section 5 cases where the Commission on its own motion acted on a section 5.

Senator **Shelby**. Mr. Chairman, can I get back on the 45 months? Now what takes 45 months? Are these complaints or what?

Mr. **Madden**. Section 4 is when a pipeline comes in and files for an increase in rates in general. Under the Commission's regulations, we also have a pipeline who has a purchase gas adjustment clause. That is where it purchases gas, it can flow through those gas charges as a quid pro quo for them coming in every 36 months where the Commission would review the rates. And that could be a restatement where they just file the current rates, or a decrease in rates.

Senator **Shelby**. Why does it take so long? I mean, you could try hundreds of cases in Federal court, very complicated cases.

Senator **Wirth**. Are there that many steps in a rate case?

Mr. **Madden**. What happens, Mr. Chairman, is that we initially set and order down, we suspend it and set it for hearing. We usually have discovery process, initially of 3 months, in which case, staff and all the other parties go out and ask for further information from the pipeline.

Senator **Wirth**. Does it take 45 months? I mean, all these steps that are set up at FERC require you to take—I mean because of the way the steps are set up?

What would happen, Mr. Madden, if we were to say to you, you have to do it in 9 months?

Mr. **Madden**. I think in very difficult rate cases where you have numerous parties that it would be difficult for the entire process to occur within 9 months.

Senator **Wirth**. What if we said 12 months?

Mr. **Madden**. I would feel more comfortable if it were about 15 months to 18 months, and I will tell you why. I mean, depending upon the situation, we can do a number of cases within the 12-month period. But if you have a number of parties, what parties want to do is try to settle with the pipeline, so they postpone. They ask the judge to postpone the procedural schedule established so that they can begin the negotiation process with the pipeline. And although these are rate increases, typically associated with these rate increases in the restructuring of services. So it is not that easy.

Now, if there is a settlement, as I said, that can be done in 8 months, and typically it has been done. But I do not believe a 12 month, in all instances, could be met.

Senator **Wirth**. Fifteen months in all instances, in your judgment would do it?

Mr. **Madden**. I think if we push staff.

Senator **Wirth**. You could handle every rate case in 15 months, or that would become the ceiling? Would everything then go to 15 months?

Mr. **Madden**. We could establish a procedural schedule for the judge to try to adhere to that process, but there would be, as we have in a number of cases found, that parties say that they do not have due process.

Senator **Wirth**. That is helpful, Mr. Madden.

Mr. **Madden**. In terms of——

Senator **Wirth**. Would we solve the problem if we did that? If we said there is 15 months to make the decision, would that solve the problem described by Senator Metzenbaum?

Mr. **Madden**. I am not too sure. And let me see if I can explain it, as I understand Senator Metzenbaum's testimony. Under his amendment to section 4, the proposal is that the rate would be suspended for 5 months, and then subject to refund. And that the Commission, then, after hearing could establish what the new rate is under his proposal.

Let me take an example. If you have $1.00 right now, which is the established J&R rate, and a pipeline comes in, let us say, for $1.25, so it is asking for a 25 percent increase. We set that matter for hearing, suspend it for 5 months, usually, and we look at that 25 cents and the other costs.

What Senator Metzenbaum's proposal would be is that during that interval period, that 25 cents is not only in question, but that $1.00 is in question. And that the Commission could go beyond the refund floor, the $1.00, and could establish a new rate, for example 75 cents effective 5 months after the suspension period.

Well, the concern there is what happens to the viability of the pipeline for that 25 cents. And that is the spread between 75 cents and the $1.00, and how the financial community will view it. There is a need, the financial community looks at the revenue stream that the pipeline has.

Senator **Wirth**. Well, I am not sure that that is what Senator Metzenbaum said that he thought his bill did. When I asked him about liability, he said there are not any liabilities, as I remember his testimony. I do not know if others of you were here, but in his oral testimony, he said it was only a look forward; it was not liabilities in reaching back. And you eliminate then the threat of liabilities, if in fact that is what Senator Metzenbaum did.

And I certainly understood him to say that.

Mr. **Madden**. Well, reading his changes to section 4, section 4 currently provides for rate increases. He removes the "rate increases" and says "any changes". So that could be a decrease as well.

Senator **Wirth**. Well, we will have to find that out.

Let us move on. Shall we do that? Mr. Madden, thank you very much. We will roll on and see if we can understand what it was, in fact, that Senator Metzenbaum is proposing. Maybe I misunderstood him, but I remember very distinctly asking him about liability and he said there were not any, so that was not a problem.

Mr. Fuller.

STATEMENT OF RONALD K. FULLER, VICE PRESIDENT, GOVERNMENTAL AND REGULATORY SERVICES, SAN DIEGO GAS & ELECTRIC CO.

Mr. **Fuller**. Mr. Chairman, San Diego Gas and Electric Company supports in concept S. 933. It should be noted that State commissions, and there is some institution regulating utility operations at the retail level in all 50 States, have a mandate which requires that those commissions provide just and reasonable rates and a reasonable return to investors. And I think that is something that is being missed by everybody.

It means that when the regulators look at rate increases, they are taking into account not only the consumer but the investor and the risk to the investor. And that is because they recognize clearly that the financial viability of the provider is critical to the consumer.

So unless there is some underlying distrust of our institutions and the individuals who regulate our industries, it would seem to me that a just and reasonable rate coupled with a reasonable return to the investors and the maintenance of sound financial viability of the provider is a mandate or standard to which we should all subscribe. And that seems to me the whole point of contention here.

Now, there has been a suggestion that perhaps you could expedite. And I think perhaps, Mr. Chairman, you had suggested 9 months, somebody 12 months, and somebody said 18 months. And I do not know where we wound up on that.

But I can tell you we are talking about huge, huge sums of consumer money here. And this, the pipeline, the gas pipeline industry, is virtually the only highly regulated—I believe it is the only highly regulated—energy industry in this country, which has its rates go into effect before they are approved. Our gas or electric rates do not go into effect until they have been proven in a quasi-judicial proceeding as being just and reasonable. So it seems to me you have to correct the situation and create an equitable situation as it relates to gas pipelines and setting their rates.

Or, alternatively, I suppose, and I would never recommend this sort of thing, you could preempt State commissions so that at least all energy industries are treated the same. I do not recommend that. If you do decide in your negotiations, that you would wish to simply expedite the process, I would strongly urge that the Congress would not allow rates to go into effect until that expedited process has worked its way.

We would urge some correction. There is a problem here.

[The prepared statement of Mr. Fuller follows:]

PREPARED STATEMENT OF RONALD K. FULLER, VICE PRESIDENT, GOVERNMENT AND REGULATORY SERVICES, SAN DIEGO GAS & ELECTRIC CO.

Mr. Chairman and Members of the Subcommittee: My name is Ronald K. Fuller. I am Vice President, Governmental & Regulatory Services for San Diego Gas & Electric Company ("SDG&E"). I want to thank the subcommittee for the opportunity today to testify in support of S. 933, the Natural Gas Ratepayers Relief Act of 1991. In sum, SDG&E supports S. 933 because it will benefit our customers by more directly linking just and reasonable rates as determined by the Federal Energy Regulatory Commission ("FERC") with the costs passed-through to our customers.

SDG&E'S BUSINESS AND FERC REGULATION

SDG&E is a combination gas and electric utility and a California corporation whose principal place of business is 101 Ash Street, San Diego, California 92101. SDG&E's vertically integrated electric business serves over one million retail customers in San Diego County and portions of Orange County, California. In the 1980's, rather than building new generation on-system, SDG&E began to purchase electricity from other utilities to meet its rapidly growing electric demand. The rates for such sales to SDG&E are regulated by FERC under sections 205 and 206 of the Federal Power Act. Today, SDG&E meets 29% of its electric peak capacity requirements (including reserve requirements) from power purchases.

SDG&E's local gas distribution business provides natural gas to over 670,000 customers in San Diego County, California. Residential and small commercial customers, and its own electric generation requirements account for nearly all of SDG&E's gas demand. Historically (and at present), Southern California Gas Company ("SoCal"), a Hinshaw pipeline with a substantial local gas distribution business, has delivered to SDG&E all of its gas supply. Until recently, SDG&E purchased its gas requirements from SoCal. SDG&E is currently converting from a requirements customer of SoCal, to a transportation-only customer. As a result, SDG&E now purchases virtually all of its gas supply directly from gas producers and marketers, and shortly will not be able to impose any gas procurement obligation on SoCal.

To access such sellers of gas, SDG&E is also a direct transportation customer of two interstate pipelines, El Paso Natural Gas Company and Transwestern Pipeline Company, currently taking interruptible transportation service. Moreover, SDG&E presently (and historically) pays SoCal for the fully allocated costs of SoCal's use of the El Paso and Transwestern systems on SDG&E's behalf. SDG&E's wholesale gas service contract with SoCal provides for assignment to SDG&E of SoCal's firm interstate pipeline capacity in an amount based on SoCal's historical use of the interstate pipelines to serve SDG&E. FERC approval for implementation of this assignment provision is currently being sought. See, *Transwestern Pipeline Co.,* 56 Fed. Reg. 20682 (May 6, 1991; *El Paso Natural Gas Co.,* 56 Fed. Reg. 21483 (May 3, 1991). Finally, SDG&E recently executed a transportation contract to participate in the Pacific Gas & Electric/Pacific Gas Transmission Expansion Project. FERC regulates the rates for transportation on interstate pipelines under sections 4 and 5 of the Natural Gas Act ("NGA").

Because state regulation provides for pass-through of gas purchase and transportation costs, much of the SDG&E customer's gas bill reflects the cost of FERC-approved rates, whether paid by SDG&E directly, or indirectly through SoCal's bills to SDG&E. Similarly, because of SDG&E's partial reliance on purchased power, a substantial portion of SDG&E customers' electric bills contain costs of FERC-approved power contracts.

HOW S. 933 WOULD BENEFIT SDG&E'S CUSTOMERS

The bill would substantially increase refund rights to SDG&E's gas customers in three ways. First, it would amend section 4 of the NGA to provide for refunds beyond those existing law provides for rate change applications. Currently under section 4, when a seller applies for a rate increase, the FERC can suspend the new rate from one day to five months, depending on its initial evaluation of the reasonableness of the new rate. The new rate goes into effect after the suspension period pending adjudication. If FERC finds the new rate excessive, the seller/applicant must refund to customers the difference between the new rate as charged pending adjudication and the rate found just and reasonable. However, the rate effective prior to the rate increase application (i.e., the rate effective during the suspension period) is the floor for measuring any refunds. In other words, if the rate ultimately found reasonable is below the previously effective rate, no refund liability accrues for amounts lower than the previously effective rate.

S. 933 would increase SDG&E's customers' ability to realize the benefits of FERC section 4 findings by (1) providing refunds where the pipeline seeks a rate decrease, and (2) removing the current floor for measuring refunds. This would result in a much closer correspondence between the rates actually paid by customers and the rates found just and reasonable by FERC.

Second, S. 933 would amend section 5 of the NGA to expand refunds in complaint proceedings by providing for seller refund liability beginning 60 days after a complaint is filed with FERC. Under current law, rate relief under section 5 is prospective only; customers get refunds for any of the complained-of rate found excessive only after the final FERC order on the complaint. Because complaint proceedings can take years to adjudicate, the existing law substantially impairs FERC's ability to remedy excessive charges. Indeed, to address this problem, in 1988, Congress amended the parallel provision of the Federal Power Act, section 206, in a manner identical to that proposed by S. 933 for section 5 of the NGA.

Third, the bill would require pipelines to file a rate case at least once every three years to ensure that rates reflect actual current costs of service. This amendment would statutorily broaden the FERC regulation to this effect by preventing pipelines from avoiding this requirement when they terminate their Purchased Gas Adjustment mechanisms, a prerequisite for the three year filing rule. El Paso and Transwestern, the two interstate pipelines now serving SDG&E, are in the process of abandoning this mechanism.

Moreover, the foregoing changes would benefit SDG&E's electric customers as well. SDG&E's on-system electric generation is fueled largely by natural gas; in 1990, 24% of SDG&E's total electric generation, including purchases, was natural gas-fired. Any refunds of gas rates to SDG&E would be reflected in the fuel costs charged SDG&E's electric customers. The benefits of S. 933 to SDG&E's customers should grow over time, as SDG&E expects natural gas' share of its generation to grow due to environmental considerations.

In sum, by removing arbitrary limits on FERC's refund authority and increasing its temporal scope, S. 933 would ensure a greater congruence between the rates found just and reasonable by FERC and what the customer actually pays for gas. It would also encourage pipelines to charge reasonably. For example, if a pipeline sells assets that were in rate base, or if it lowers the quality of its service, the current law "rewards" the pipeline for not lowering its rates. This is so because there is no requirement to regularly file rate changes, and no other incentive to do so; if a customer complains to FERC, refund liability runs only from the date the FERC finds the rate excessive, which is often years after the complaint is filed.

SDG&E'S EXPERIENCE UNDER THE FEDERAL POWER ACT IS INSTRUCTIVE

SDG&E has had substantial experience in challenging power sales contracts under provisions of the Federal Power Act that are similar to sections 4 and 5 of the NGA.

On the electric side, SDG&E has been very aggressive in administering FERC-regulated power purchase contracts. This reflects the more bilateral (as opposed to multi-party) structure of the electric industry, where transactions tend to be consummated by individual contract rather than by tariff, as well as SDG&E's recent decision to rely on purchases under FERC jurisdictional sales contracts to meet its need for new electric resources. Since 1985, SDG&E has filed eight complaints or protests and interventions at FERC on the basis that the rates charged to it were excessive. To date, we have received refunds totaling $28.5 million, with other refunds still pending.

While in most instances SDG&E has had opportunity for retroactive relief because its claims were for breach of contract under formula rates (as opposed to a claim that rates were unreasonable or excessive apart from the contract), SDG&E has faced situations where it could seek only prospective relief from an excessive rate. For example, in *Alamito Co.*, 37 FERC ¶61,279 (1986), Alamito had applied for a rate decrease to reflect a change in capitalization under a formula rate in its contract with SDG&E. SDG&E challenged the proposed rate as too high. The Commission found that it could not order refunds retroactively, and it set the rates for investigation under section 206 of the Federal Power Act for prospective relief only.

Had the Federal Power Act been amended in a manner similar to that proposed for the NGA in S. 933, SDG&E's customers would have had the opportunity in this situation for refunds for any amounts found excessive. While SDG&E has not had an opportunity to test the 1988 amendment to section 206 of the Federal Power Act, we are confident that the refund retroactivity it provides will "pay-off" in future contract administration efforts on behalf of our customers.

On the gas side of its business, SDG&E has not been as active before the FERC. This is because, historically, SDG&E incurred few costs as a direct natural gas customer of an interstate pipeline. Most of SDG&E's concern with FERC jurisdictional costs was derivative as SoCal's customer. Also, natural gas pipelines tend to have many direct customers subject to the same rate or tariff, and such customers therefore have similar interests. With SoCal and other direct interstate pipeline customers aggressively administering their FERC jurisdictional costs (including FERC litigation), any SDG&E participation in FERC gas proceedings was merely cumulative to that of the direct customers. However, we expect this will change to the extent that SDG&E has more direct customer relationships with interstate pipelines in the future as a result of deregulation, including provision for brokering of pipeline capacity. Overall, we expect customer benefits to be realized if S. 933 is enacted.

CONCLUSION

SDG&E appreciates this opportunity to testify in support of a measure that is sure to benefit our customers. Thank you for your consideration.

Senator WIRTH. Thank you. Mr. Olson.

STATEMENT OF JOHN E. OLSON, VICE PRESIDENT, EQUITY RESEARCH, GOLDMAN, SACHS & CO.

Mr. OLSON. Mr. Chairman, in answer to your question about whether you should make this a more expeditious process, I as perhaps the only member of the panel from Wall Street here, the school of hard knocks, lately it seems, would applaud that kind of process. Clearly we are operating under a 50-year old modus operandi, if you will. In terms of regulatory due process, it is showing its age. Other people do it better in other countries. Canada comes to mind, for instance.

And I would just editorialize on what Mr. Madden has said, in support of him, to some degree. And that is we have just gone through 5 years or 6 years turbulent years, probably the most turbulent in the history of the Commission, where rate cases got stretched out to unheard of proportions and levels. And Mr. Fuller has just probably gone through one with El Paso Natural Gas, which is the last of the Mohicans, perhaps here.

I think, though, that episode in FERC history is perhaps closing now. And if there is any better way to come around the complications of S. 933 that they pose, I would urge your consideration of those.

[The prepared statement of Mr. Olson follows:]

PREPARED STATEMENT OF JOHN E. OLSON, VICE PRESIDENT, EQUITY RESEARCH, GOLDMAN, SACHS & CO.

INTRODUCTION

Mr. Chairman and members of the subcommittee, I would like to thank the subcommittee members and staff for the opportunity to testify on the provisions of S. 933, "The Natural Gas Ratepayers Relief Act of 1991." Wall Street has a vital interest in any proposed natural gas legislation. Indeed, the natural gas industry is capitalized at over $100 billion of debt and equity securities. In these terms, it is the fifth largest in American industry. And it is left to Wall Street to underwrite and trade these securities with the understanding that a pipeline's cost of service and attendant risks will be accompanied by just and reasonable ratemaking and regulation. It should not go without saying that the partial deregulation programs of the past seven years created a traumatic breach of this risk/return equation. Indeed, deregulation and deflation combined to make gas a real bargain for consumers for much of the 1980's. But the FERC Open Access Orders (436/500) and their offspring have greatly diminished earnings and cash flow predictability, not to mention outright returns, since 1984 (please see attached tables). In fact, the entire FERC package has come to be viewed as something of a Trojan horse to investors: An uninvited guest with unintended consequences. Massive losses, restructuring, and even one "prepackaged" bankruptcy have been witnessed. During the past six years, we estimate that interstate pipelines have earned only about 7%-8% on their equity. This contrasts with 15.2% realized by American Industry, exemplified by the Standard and Poor's index data for 400 corporations. Given the further fact that investors could have earned about 8%-9% risk free in government bonds since 1985, pipelines have hardly been compelling investments.

It is from this school of hard knocks that I address the provisions of S. 933. Although we at Goldman, Sachs do not profess deep rate and regulatory expertise, our conviction is that this bill may prove to be another Trojan horse, poorly serving pipelines, consumers and investors alike, and one that would be ridden hard by members of the energy bar. We believe it entirely likely that consumers in particular will end up paying for more manhours of litigation and unproductive management time dealing with the consequences of this bill.

ARGUMENTS

The Ratepayers Relief Act proposes several adjustments to the Natural Gas Act of 1938. These appear simple at first reading, but become quite troubling after their implications are analyzed.

- Amending Section 5 to require refunds for overcharges in a rate case-decrease filing does violence to the proscription against retroactive ratemaking.
- Amending Section 4 by eliminating refund floors creates ripple effects that go to the core of rate making. It is hard to imagine something more confusing to investors, shippers and pipeline operators alike. Regulatory due process becomes second guessed, exposing everyone to more confusion. For investors, this would serve to lower confidence again in the rate making process. Bond ratings could suffer, causing interest rates to inflate. Equity returns might need to be revised higher in light of greater perceived risks and further erosion in investor confidence. We question whether consumers would be well served in the intermediate and long run.
- The Ratepayers Relief Act comes at a time when the pipeline industry is seeking much greater access to the capital markets. It also occurs when the industry is still grappling with large transition issues that are still being debated at every level of the industry. Fully $6 billion of new pipeline projects in the United States and another $4 billion in Canada are well along in the permitting process. During 1990 alone, the FERC approved several billion dollars of construction certificates. These sums need funding from the world credit markets. Project financings of several major joint venture systems would be seriously jeopardized by the creation of rate uncertainty.
- By possibly making United States pipeline investors less creditworthy, S. 933 may have the side-effect of encouraging more Canadian imports. Domestic producers become disadvantaged in the process. Canadian pipelines have made major progress in serving the United States markets. Since 1987, gas deliveries from Canada have grown by 52% and now account for 8.1% of the United States market. In the first quarter of 1991 alone, Canadian imports rose 10% while United States production remained flat. In the next five years, Canadian volumes are expected by observers to rise another 40%-50%. This is being accomplished with typically more expensive delivered gas prices, but also with ironclad rate protections. Any shortfalls in U.S. pipeline construction due to S. 933 are sure to be compensated for north of the border.
- In the current climate of progressive legislative proposals designed to expedite pipeline construction, reduce air pollution, back out oil imports and to encourage gas consumption, S. 933 strikes us as retrograde motion. For natural gas to fulfill its national energy role as a multiple solution for problems, it will require proactive proposals.

In sum, we believe that S. 933 could harm the financial viability of the pipeline industry if enacted. It attempts to extrapolate from unusual conditions in the pipeline industry during the drawn out restructuring struggles of 1985-1989. This was a period in which pipeline investors had to absorb over $3 billion of Order 500 write-offs. It was also characterized by the industry's earning perhaps 7%-8% on its regulated equity, assuredly not a controversial level. These times are clearly over, and we think it would be unwise to let these amendments pass muster.

Thank you very much.

Returns On Equity

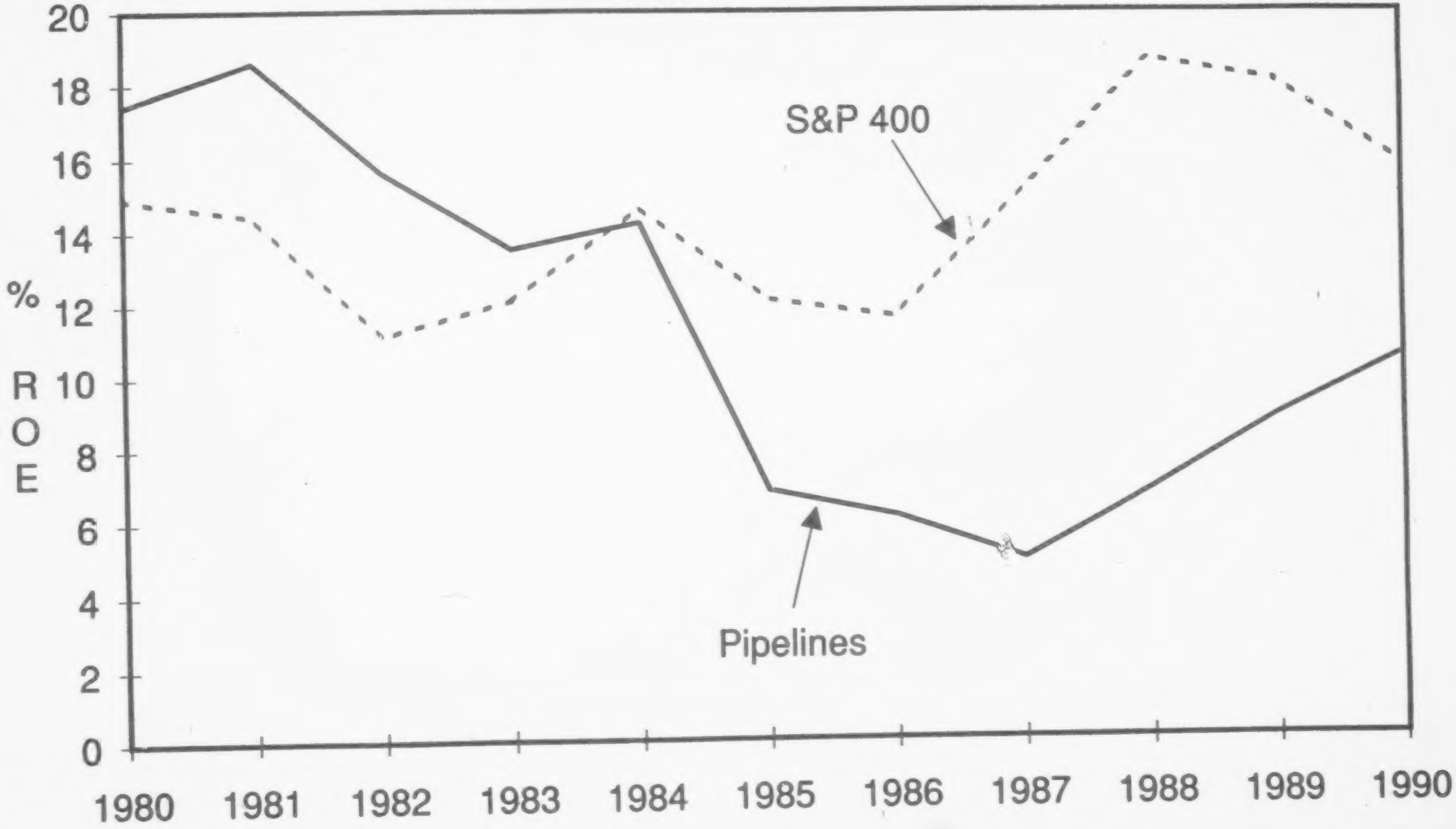
	USA Oil & Gas Fields	Major Pipeline Companies	Local Distribution Companies	S&P 400
1980	22.9 %	17.4 %	12.8 %	14.9 %
1981	20.2	18.6	12.4	14.4
1982	14.5	15.6	11.8	11.1
1983	12.9	13.5	14.0	12.1
1984	13.0	14.2	15.7	14.6
1985	9.9	6.8	14.0	12.1
1986	2.4	6.1	12.0	11.6
1987	4.5	4.9	11.6	15.1
1988	2.6	6.8	13.5	18.7
1989	3.5	8.8	13.5	18.1
1990E	4.9 %	10.5 %	13.3 %	15.8 %

Sources:

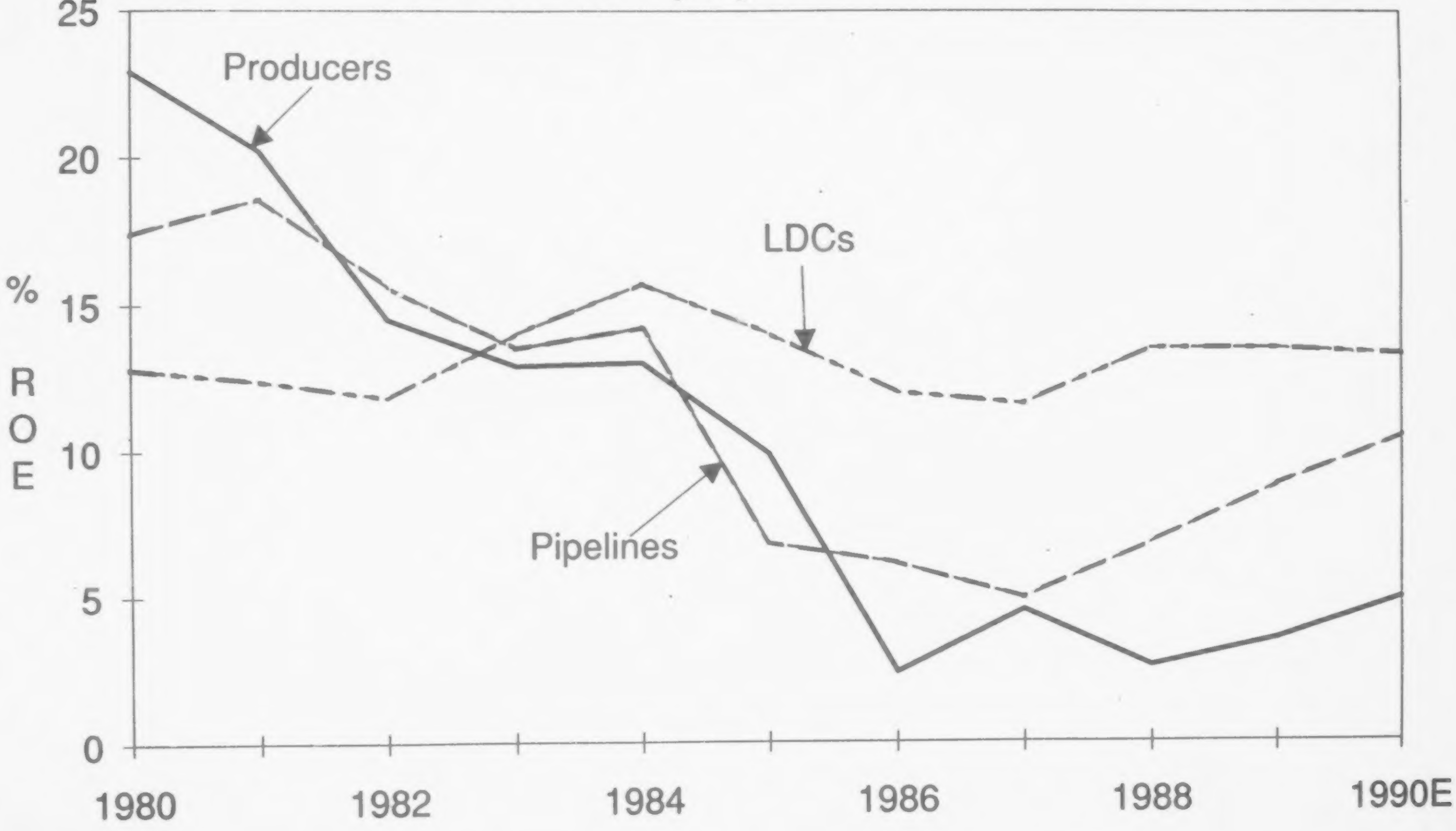
USA Oil and Gas Fields: Profitability Study: Crude Oil and Natural Gas Exploration and Production Activities in the United States. Shell Oil Company.

Major Pipeline Companies: Statistics of Interstate Pipeline Companies: 1980-1989. Energy Information Administration.

Local Distribution Companies: Gas Facts: 1980-1990. American Gas Association.



Return on Equity Profile, 1980-1990E



Return on Equity Profile, 1980-1990E

INTEREST RATES

				Moody's			
	Governments					Spread Vs. 30 Year	
	90 Days	30 Years	Spread	AAA	BAA	AAA	BAA
1977	5.51	7.70	(2.19)	8.02	8.97	0.32	1.27
1978	7.57	8.49	(0.92)	8.73	9.45	0.24	0.96
1979	10.04	9.29	0.75	9.63	10.69	0.34	1.40
1980	11.51	11.30	0.21	11.94	13.67	0.64	2.37
1981	14.08	13.44	0.64	14.17	16.04	0.73	2.60
1982	10.69	12.76	(2.07)	13.79	16.11	1.03	3.35
1983	8.52	11.18	(2.66)	12.04	13.55	0.86	2.37
1984	9.57	12.39	(2.82)	12.71	14.19	0.32	1.80
1985	7.47	10.79	(3.32)	11.37	12.72	0.58	1.93
1986	5.98	7.78	(1.80)	9.02	10.39	1.24	2.61
1987	5.82	8.59	(2.77)	9.38	10.58	0.79	1.99
1988	6.68	8.96	(2.28)	9.71	10.83	0.75	1.87
1989	8.12	8.45	(0.33)	9.26	10.18	0.81	1.73
1990	7.51	8.61	(1.10)	9.32	10.36	0.71	1.75

Source: Federal Reserve Bulletin.

Senator WIRTH. Thank you very much, Mr. Olson.

Mr. Kuehn.

STATEMENT OF RONALD L. KUEHN, JR., CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, SONAT, INC.

Mr. KUEHN. Thank you, Mr. Chairman. I will address specifically the two questions you asked. First, is there a problem, and is time certain a solution?

I would suggest to you that there is not a problem. Certainly not a problem, if one exists at all, of the magnitude you are trying to solve in the National Energy Strategy Plan. Points of evidence, natural gas rates to consumers are lower than they have been in 6 years. Natural gas is an absolute bargain compared to the other energy sources such as electricity or oil. That is why everybody wants to expand natural gas services.

Natural gas pipelines are certainly not having a bonanza. Evidence the Columbia statement today, evidence Mr. Olson's testimony, which indicates that the returns on equity of natural gas pipelines is somewhere in the range of 10 percent compared to industry-average returns of 15 percent compared to distribution company earnings of 13 percent returns on equity. So the natural gas pipeline industry is not getting fat.

Moreover, the regulators at the State level, NARUC, which is an association of State regulatory commissions, has the opportunity to vote as to whether to support a proposal similar to Senator Metzenbaum's, and they voted to reject it because of the rate uncertainties involved. And these are the very people who are charged at the State level with protecting the consumer. So they do not think it is needed. So I conclude there is no problem.

As to a time certain at the FERC, I do not think that is the answer. My experience at the State levels, where there is a time certain set for rates, and that used to be the case in the State of Alabama, the Commission would wait until the eleventh hour, they would come out with an order that approved rates that were patently low. The utilities then took that off to the State supreme court, and 2 years later, the supreme court ended up setting rates so there was no uncertainty. At the State level, at least in my experience, it has not worked. It forces a bad result that is then taken off to the courts for a final action.

Moreover, with all due respect to Mr. Fuller, there is an enormous amount of capital that is invested in the interstate pipeline business and which the National Energy Strategy would require more capital invested to meet its goals. And pipelines cannot sit around for 12 months or 15 months waiting to get a return on those enormous capital sums while the process is going through FERC.

And while I am as critical as anyone, and have lived with it for 20 years, the delays at the FERC and the frustrations at the FERC, with all due respect, it is not a question of whether the rate should be $1.00 or $1.10. It is an extremely complicated situation, particularly today, when the FERC is using rate cases as a way to change services. Who pays for those services? What kind of services are provided? It is just not a matter of whether you pay a nickel or a dime, it is complicated.

In my experience, my company can usually get a rate case out of the way in 15 months to 18 months. It has always been by settlement. We have not litigated to a final conclusion a rate case in 20 years. I really do not think there is a problem, and I certainly do not think the solution is forcing a bad result just to meet a time table, and then a year and a half later, having the court of appeals send it back to the FERC to fix it. I do not think that gives you anything.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Kuehn follows.]

PREPARED STATEMENT OF RONALD L. KUEHN, JR., CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SONAT, INC.

Mr. Chairman and members of the subcommittee, I am Ronald L. Kuehn, Jr, and I am the Chairman, President, and CEO of SONAT, Inc. I am also the Vice-Chairman of the Interstate Natural Gas Association of America (INGAA). I am pleased to appear before the Subcommittee on behalf of INGAA to present the views of the interstate natural gas pipeline industry. INGAA is a non-profit national trade association representing virtually all of the major interstate natural gas transmission companies operating in the U.S. Approximately 90% of the nature gas which is sold and transported in interstate commerce flows through facilities owned ad operated by INGAA's member companies.

You have asked me to address how the provisions of S. 933, the "Natural Gas Ratepayers Relief Act of 1991," would affect the natural gas industry. I believe that the provisions of S. 933 are unnecessary in that they purport to address a problem or need that does not exist and, if enacted, would seriously undermine the financial integrity of the natural gas industry which has not yet recovered from the trauma of take-or-pay and is in a major transition to a more competitive environment. The provisions of S. 933 will seriously and negatively impact the certainty and quality of pipeline earnings which in turn could inhibit the pipeline construction necessary to meet the environmental and energy security goals of this Congress and will lead ultimately to greater financial costs being flowed through to the rate payer. Moreover, implicit in S. 933 is the notion that the pipeline industry is earning unreasonable rates of return. The evidence is strongly to the contrary. Clearly the pipeline industry has not earned respectable returns let alone unreasonable returns in the past five years. Given that the industry is currently caught in the tightening vise between regulation on the one hand and increased competition on the other, it will be increasingly difficult to earn reasonable returns in the future. So one wonders what interests S. 933 is protecting or more importantly, furthering.

THE NATURAL GAS ACT

The NGA has for over 50 years provided the necessary checks and balances between the right of regulated natural gas companies to earn a reasonable return on its investment, and the right of rate payers to receive reliable natural gas service at the lowest reasonable cost. Under Section 4 of the NGA, a natural gas company has the right to propose new rates through a filing with the Federal Energy Regulatory Commission. Under Section 5 of the NGA the Commission may initiate on complaint or its own initiative, an investigation of a pipeline's rates and order prospective changes.

Pipeline proposed rates, whether higher or lower than existing rates, become final only after the FERC has reviewed them extensively and deemed them just and reasonable. Rates that have been through a complete review, possibly including rehearing by the FERC and a court case, are final rates which the customer, the pipeline and the investor can trust not to change after-the-fact.

A pipeline filing to change its rates pursuant to Section 4 is required to give a 30-days notice to FERC and its rate payers. Before close of the notice period, the FERC has the option of approving or rejecting the new rates or suspending them for up to five months pending further review. If after five months the review is not complete, the proposed rates become effective subject to refund. In the case of a proposed rate increase, the refund potential is the difference between the proposed rates and final rates, plus interest accrued after the five month suspension period. Stated another way, the existing final rate establishes a floor under which the FERC-ordered refund cannot go even if the new approved rate is below that level. Likewise changes under Section 5 can be made effective only prospectively. These provisions are consistent with the general regulatory distaste for retroactive rate making. It serves to provide a necessary certainty to pipelines, their customers and the financial markets. S. 933 would modify these provisions and introduce retroactive ratemaking, which I believe will work to the detriment long term of the very public it apparently is designed to protect.

CHANGES PROPOSED IN S. 933

S. 933 would amend Section 4 of the NGA in several ways. First, it would allow the Commission to require refunds below the approved just and reasonable rates previously in effect. Second, it would require natural gas companies to file new rates every 36 months regardless of how recently the current final rates were approved. The proposed bill would also amend Section 5 to require the Commission to set a "refund effective date" at a point in time possibly prior to a Commission finding in a Section 5 proceeding that the pipeline's rates were unjust or unreasonable. I will address each of these changes in turn and show why INGAA opposes them and suggests that they be dropped.

REFUNDS BELOW LAST APPROVED RATES

S. 933 would permit the Commission, in a section 4 proceeding, to require refunds to levels below existing lawful rates, in effect, removing the refund floor. INGAA opposes this provision for several basic reasons. First, it is clearly retroactive ratemaking, which the courts have historically and consistently struck down, most recently with respect to Order 500 which was designed to enable pipelines to recover take-or-pay costs. Pipelines are not allowed to recover costs retroactively; and therefore FERC should not be allowed to adjust rates downward retroactively.

Secondly, the changes will result in uncertainty for the pipelines, and consequently the distributors and producers at the very time the pipeline industry needs rate certainty. This rate uncertainty distorts and undermines market signals and can result in poor decisionmaking. Suppliers, shippers, ultimate customers and the pipelines will not know, when making purchasing, shipping, pricing, or discounting decisions, whether their decisions are based on accurate rate information. A fundamental principle of rate regulation has been a prohibition against retroactive ratemaking. This has provided assurance to customers that decisions based on filed rates would not be undermined by changing economics after the transaction has already been completed. This proposal increases uncertainty and the likelihood that decisions will be made based on unreliable economics.

Clearly one of the most significant negative impacts of this fiscal uncertainty will be in financial markets. Without a floor on rate refunds, there will be no limit on a pipeline's refund exposure. This will quickly be recognized by auditors and pipeline company financial statements almost certainly will be certified on a qualified basis. This uncertainty will cause financial markets to view pipelines as riskier ventures and will result in difficulty in obtaining financing and in higher interest rates where financing is available. This could result in fewer new pipeline projects; a prospect which is certainly at odds with the objectives of the National Energy Strategy to increase the use of domestic natural gas.

36 MONTH FILING REQUIREMENT

I believe that changes to the rate process should aim at streamlining the process. We need fewer rate cases, not more! S. 933 would produce more rate cases, more rate uncertainty and more regulatory delays. The average time for the Commission to approve pipeline rates has almost doubled over the past several years from 15 months in the early 1980's to about 29 months in recent years. If S. 933 is enacted it could well result in a pipeline company being required to make a new rate filing under the 36-month rule before the previous rate filing is dealt with by FERC. How is this in the public interest?

The 36 month requirement coupled with the retroactive ratemaking aspects of S. 933 will render final rates a thing of the past. The industry, the consumer and the country will be truly ill-served by such a development and its negative impact on financings, costs and future expansions which I referred to earlier.

RETROACTIVE RATEMAKING UNDER SECTION 5

I believe that the proposed changes to Section 5 are likewise misguided, amount to second guessing the Commission, would undermine the authority of the Commission as the agency empowered by Congress to determine just and reasonable rates for natural gas companies and would add further to the problem of rate uncertainty. Given the other proposed provisions of S. 933 one must wonder why this is even necessary—unless of course the whole intent is punitive.

It appears that the main rationale for this proposed change in the NGA is that a seemingly parallel change in the Federal Power Act (FPA) was enacted by Congress in 1988 with regard to rates changed by electric companies engaged in wholesale of electricity in interstate commerce and, evidently, the fact that no adverse consequences followed for the electric industry.

There are major differences, however, between interstate nature gas pipelines and electric utilities engaged in wholesale power sales. First and foremost, 100% of a pipeline's business is regulated by FERC but only a very small part of a power company's business is regulated, 10% or so. What could spell a disaster for pipelines, therefore, would have little impact on power companies.

Further, while both electric utilities and interstate pipelines have faced competition from alternative fuels, electric utilities have not experienced the radical changes experienced by the pipeline industry. Congress in the NGPA and FERC in its series of open access transportation orders have clearly pointed pipelines toward market based regulation. S. 933 would be a huge step backward from market based regulation.

CONCLUSION

I would like to conclude turning to what I consider to be the most significant negative aspects of S. 933. Because the rates and therefore the financial performance, stability and viability of pipeline companies will be uncertain at best—both as to the past and the future, it will be very difficult for prudent pipeline managements to plan and commit significant capital to new projects. Who among this distinguished panel would commit substantial capital in a business where you don't know how much you earned in the recent past, let alone how much you will be allowed to earn in the future. I for one am not smart enough to know how you run a business with those characteristics. Certainly you would do it with great caution! Also, pipeline rates under S. 933 would be viewed by the financial community as highly risky and unpredictable, making it more difficult and more expensive for pipelines to raise funds for expansion projects, even if management were courageous enough to undertake such projects. Indeed, when this thrust of S. 933 is viewed together with its requirement that a new rate case be filed every three years and given the average length of time before filed rates become final at FERC, pipelines will literally never have final rates in place. Under such circumstances I do not believe pipelines would ever be able to obtain an unqualified financial statement from their auditors.

Without clean financial statements, pipeline bond ratings would drop—financing for pipelines would become more difficult and costly, and many worthwhile projects will never be undertaken. How is this consistent with the national interest? In other legislation both passed and pending before this Congress, pipelines appear to be expected to greatly expand their ability to attach and deliver natural gas to aid the environmental improvements sorely needed and to displace foreign oil imports, with all the benefits that entails.

Many of the provisions of the Clean Air Act of 1990 call upon pipeline companies to invest substantial sums in new capacity to provide new or expanded gas service to electric generation facilities and other new markets to help in the control of their air emissions. Also, in order to help with the national priority of reducing dependence on imported oil, a recent study ("Displacing Imported Oil with Natural Gas," INGAA Issue Analysis 91-1, May 1991) found that interstate natural gas pipeline companies, in the event of an oil disruption overseas, would need to invest a minimum of $1.3 billion to provide sufficient gas service to reduce oil imports by approximately 236,000 barrels per day. The uncertainty created by S. 933 would cast a shadow on the financial strength and stability of pipeline companies, to provide additional gas service and also make prudent pipeline managements very reluctant to undertake worthwhile expansion projects. It is entirely counter productive to these goals to initiate legislative changes that would threaten the financial strength of the natural gas pipeline industry.

This is particularly true when there is absolutely no demonstrated need for S. 933. Over the last 10 years pipelines' earnings have generally declined and most have been below the FERC established just and reasonable return. Pipeline earnings have certainly fallen below industries with comparable risks. Congress and the FERC have opted for less, not more regulation of pipelines and residential and commercial rates have declined. I cannot understand why under these circumstances legislation such as S. 933 is necessary or appropriate. The checks and balances built into the NGA by virtue of the existing Sections 4 and 5 protect both consumers and gas companies and have been doing so for over 50 yeas.

The courts have found on several occasions that the currently existing balance between Sections 4 and 5 is in the best interest of the public:

> Recognizing that it is in the public interest that companies receive adequate revenues to maintain high quality service, Congress designed sections 4 and 5 to protect companies against regulatory lag and provide a degree of certainty in their rate schedules . . . Section 5 rate reduction orders may be prospective only. This ensures rate stability; companies may count on receiving previously approved revenues without the threat of an indefinite refund requirement at a later date.[1]

There is simply no evidence of any problem which needs the cure of S. 933. To the contrary, pipelines are just emerging from a traumatic, federally mandated restructuring of their industry and need more certainty and higher quality earnings if they are to expand to meet the environmental and energy security needs of the future.

Senator WIRTH. Thank you very much, Mr. Kuehn.

Ms. Samuels.

STATEMENT OF MARGARET ANN SAMUELS, FEDERAL COUNSEL, OHIO CONSUMER COUNSEL, ON BEHALF OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

Ms. SAMUELS. Thank you, Mr. Chairman. I have, in fact, been in a great many FERC cases, primarily rate cases, but also cases called PGA cases, in which you examine the purchasing practices of pipelines. And I represent the State Utility Consumer Advocates. We represent the captive consumers that end up paying these rates. We believe that, yes, there is a problem and that S. 933 does address it. The problem is fairly limited.

You do already have rates subject to refund in a great many instances. In a section 4 rate case, which the pipeline comes in and files, the pipeline is able to put its rate into effect, but they are subject to refund for the entire pendency of the case. That does not seem to cause the pipelines a great problem or cause the financial industry to say that everything is uncertain.

In the PGA cases, because that is a particular kind of a case, those rates are subject to refund and can stay subject to refund for years. In most instances there is no financial integrity question about it.

I was in one case involving Panhandle Eastern Pipeline Company in which we challenged their practices in 1984. It was not until 1990 that we got a decision from the court of appeals that the FERC decision, which had taken them 4 years to issue, was wrong. All that time Panhandle's gas costs, $100 million of them for 1984, were subject to challenge. I never saw any qualification of their financial results because of that. And there are a lot of other uncertainties that exist with respect to pipelines. So the particular uncertainly question, I think, is just a red herring.

There are certain cases in which the FERC finds, or is asked to find, that rates are unjust and unreasonable. And in those cases, there is not opportunity for refund, as has been said.

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[1] *Panhandle Eastern Pipeline Co.* v. *FERC*, 613 F.2d 1120, 1129 (D.C. Cir. 1979), cert denied, 449 U.S. 889 (1980).

The major thing that this bill does is to say, yes, you consumers, you ratepayers, will be able to get refunds of rates that are found to be unjust or unreasonable. And that is what happened with the Federal Power Act. It has been working very well.

The reason I submit that you have not seen more than three complaint cases submitted in the last few years is because of the futility of it. If you are not going to get a decision for 3 years or 4 years, and that effect will be prospective only, why challenge the rates at all? In fact, the Supreme Court has, long ago as the Hope case, said that the pipeline could not appeal a finding by the Commission that the pipeline's rates were unjust or unreasonable because the pipeline was not out any money. They did not have to refund anything to the consumers.

The question about limiting time, we went through a period in the mid 1980's when the then Chairman of the FERC dictated that all rate cases had to be tried within 5 months. What that does is give the pipeline the ability to withhold information from the litigants until it is too late. And the administrative law judges are under the gun from the Commission to hold a hearing. You come in and say we have not been able to get this information, and it is a denial of due process.

What NASUCA has supported, and we have some resolutions which I will supply for the record, is a deadline for the FERC once an initial decision is issued to put out its final order, a deadline for issuing orders when you do have an agreement in a settled case when there is a settlement proposed and nobody is opposing it. We have had a number of instances in recent years where that took months and months, just to issue a decision on an uncontested settlement. And similarly, we would like to see a deadline on remands from the court of appeals, which also—there is nothing that says the FERC has to act within a given time, although the court has recently started putting its own deadlines on because it has to have it.

But to put a specific deadline on how long it takes to try a case can only benefit the pipeline and not those who are challenging the reasonableness of its rates. The elimination of the PGA makes the refund provision even more critical in instances where it applies. The fact that the pipelines no longer sell most of the gas that they move—they move it for other people—so that they have been suspending these provisions in their rates that do require an every-3-year rate case filing. For that reason, we think that both the provision for the refunds and the provision that makes the rates subject to review every 3 years are important for consumers and do not lead to too much uncertainty for the pipelines.

I would also like to note that the Citizen Action and Consumer Federation of America authorized me to state that they support the NASUCA position which is set forth in our testimony. On the question about expanding into new markets and whether this provision would have any impact on that, I think NASUCA's response to that is that natural gas can only expand into new markets—pipelines can only expand into new markets if their rates are competitive, if they are just and reasonable, and if they are competitive with alternate fuels. We should not ask existing ratepayers to subsidize that.

And I would be glad to answer any questions.
[The prepared statement of Ms. Samuels follows.]

Prepared Statement of Margaret Ann Samuels, Federal Counsel, Ohio Consumer Counsel, on Behalf of the National Association of State Utility Consumer Advocates

I. INTRODUCTION

On behalf of the National Association of State Utility Consumer Advocates (NASUCA). I wish to think the subcommittee for this opportunity to submit testimony on the effects of S. 933, the proposed Natural Gas Ratepayers Relief Act of 1991, from the viewpoint of state utility consumer advocates. Ny name is Margaret Ann Samuels and I chair NASUCA's natural gas committee. NASUCA is composed of 42 state-designated offices of utility consumer advocates in 30 states and the District of Columbia. NASUCA members appear regularly on behalf of utility ratepayers before state and federal regulatory commissions and courts. We are frequent intervenors at the Federal Energy Regulatory Commission (FERC), as interstate natural gas ratemaking has a profound effect on the consumers we represent.

NASUCA's positions on regulatory issues are set out in the organization's resolutions. The resolutions pertinent to my testimony are noted below and attached for your information.

II. NASUCA HAS SUPPORTED NATURAL GAS ACT AMENDMENT TO PROVIDE REFUNDS OF OVERCHARGES

NASUCA support for changes in federal regulatory law to allow the FERC to order refunds of amounts found to be in excess of reasonable rates is well established. The organization endorsed the concept in the 1958 amendment to the Federal Power Act. That amendment, known as the Regulatory Fairness Act, amends FPA section 206 to allow refunds when rates are found excessive in a complaint or investigation.

In 1989, we passed a resolution calling for a similar amendment to the NGA. See Resolution 1989-2, attached. At our recent midyear meeting in May 1991, NASUCA members approved Resolution 1991-11, supporting the need for continued regulation of interstate pipeline rates and for FERC review of those rates at least every three years. A copy of that resolution is also provided.

NASUCA participated in a joint press briefing in early April, 1991 on natural gas legislation, in which Associated Gas Distributors (AGD) and American Public Gas Association (APGA), as well as Citizen Action and Consumer Federation of America, advocated measures to benefit consumers of natural gas. AGD and APGA are trade associations representing respectively, a large group of local gas distribution companies (LDCs) and municipal gas distributors. One of the proposals supported by that group was the enactment of changes to the Natural Gas Act to parallel the 1958 Regulatory Fairness Act changes to the Federal Power Act.

We are pleased to see that S. 933 responds to consumer concerns on these issues.

III. S. 933 WILL ENABLE RATEPAYERS TO OBTAIN FAIR RATES IN CIRCUMSTANCES WHERE THEY ARE PRESENTLY UNOBTAINABLE

It is well recognized that the FERC may not order refunds from any rates or practices it finds unjust and unreasonable, if those rates or practices have been previously approved. Section 5 of the Natural Gas Act (NGA) allows the commission to order only the rate, practice, etc., that shall be "thereafter" in force. 15 U.S.C. Section 717d. Courts have made clear that, however unfortunate the result, Section 5 permits a remedy to be ordered only prospectively from the date of the finding when a violation of reasonable rates is found.

The U.S. Supreme Court correctly observed that "[g]as purchasers, therefore, have no protection from excessive charges collected during the pendency of a ¶5 proceeding." *Atlantic Refining Co.* v. *Public Service Comm. of N.Y.* 360 U.S. 378 at 389 (1959).

Thus a rate reduction may be sought in a complaint case or a rate case, but it may take years to achieve. By that time, circumstances may well have changed and prospective relief could be nugatory.

Conversely, NGA Section 4 permits a pipeline seeking a rate increase or change in its tariff conditions to make the change effective by no later than six months after the date of filing. If the increase or change sought by the pipeline is eventually found to be excessive or unjust, the pipeline must refund the excess, but it has had the use of the funds in the meantime.

S. 933 establishes a reciprocal right for ratepayers to obtain rate reductions from a date certain, flowing from the filing of a complaint or institution of a Commission investigation. Its language on refunds closely parallels that of the Regulatory Fairness Act, and is basically identical to the amendment to the 1989 Natural Gas Decontrol Act proposed on the floor of the floor of the U.S. Senate. That proposal received 43 votes in the full Senate even without benefit of hearings.

The problem inherent in NGA Section 5, that relief cannot be provided for overcharges or excessive rates paid prior to the date of a FERC finding, is not one of the problems that can be solved by expediting the decision-making process at the FERC or imposing deadlines. NASUCA supports enacting certain statutory deadlines for Commission action. These include a time limit for the issuance of orders following the initial decision of an administrative law judge and orders on rehearing and on remand from a reviewing court. However, when establishing the facts that show excessive pipeline charges or unreasonable practices, it is necessary to allow sufficient time to gather and present evidence. Because the pipeline controls the evidence, the process can be irrevocably crippled by limiting the parties' ability to review and analyze the data.

Under this detailed evidentiary process, the pipeline is protected by having its rate proposals go into effect, when rate changes are initiated by the pipeline. Pipeline customers will have any excessive amounts eventually refunded in such proceedings. But when customers, consumer advocates or state commissions—or the FERC itself—initiates a case charging that rate reductions are in order, once again it is the pipeline, not the ratepayers, that is protected during the pendency of the case. The rates that are the subject of the hearing not only remain in effect, but are not subject to refund. The only relief available is an eventual rate reduction, which may not occur for two years or more. Unfortunately this gives the pipeline incentive to drag its feet in the process of supplying information and bringing a proceeding to conclusion.

You may be told that few complaint cases are filed at the FERC, or that its informal enforcement process takes care of most problems. The truth is that the unavailability of refunds makes the filing of a complaint appear a futile act. Moreover, the informal process can only accomplish a prospective remedy.

It may also be said that pipeline earnings will be considered at risk, if their rates are subject to refund or reduction when a complainant alleges overcharges. Electric utilities predicted similar dire consequences during hearings on the Regulatory Fairness Act. No such consequences have occurred. The refund provision under the Federal Power Act has been in effect for three years, and is functioning as intended.

It is difficult to comprehend why a pipeline should be protected from having to refund unreasonable rates. Other merchants are subject to provisions, such as the Federal Trade Commission Act, that require refunds of amounts associated with unfair or deceptive practices. Automobile manufacturers must issue recall notices when there is a problem with their product.

S. 933, like the Regulatory Fairness Act, provides a definite refund effective date. That date is triggered by the filing of a complaint, and does not go back before the date a complaint is filed, or a FERC investigation is announced. It makes rates more responsive to the need for changes, as well as more fair. It is thus both equitable end efficient.

An example of the unfairness of the present statutory scheme is the complaint raised by the Pennsylvania Office of Consumer Advocate in a FERC proceeding in 1985 that a pipeline's practices were causing unreasonable high rates for consumers. The pipeline argued that even if the FERC found it to have been imprudent, there was no obligation to provide refunds because of Section 5 of the NGA. In that instance, consumers did ultimately obtain refunds, only because it was under the automatic adjustment clause of the pipeline's PGA, not in a regular rate proceeding. National Fuel Gas Supply Co., FERC Docket No. TA85-1-16. For other examples, see the circumstances in *Tennessee Gas Pipeline Co.* v. *Federal Power Comm.*, 606 F.2d 1373 (D.C. Cir. 1979), and *Arkla* v. *Hall*, 453 U.S. 571 (1981).

IV. PROVIDING FOR PERIODIC FERC REVIEW OF PIPELINE RATES WILL ENSURE FAIR RESULTS FOR THE ENTIRE INDUSTRY

S. 933 adds a provision to Section 4 of the Natural Gas Act that supplies another element of fairness in the regulatory process. NASUCA's Resolution 91-11 is directly supportive of this measure, which provides review every three years of pipeline rates if no rate case is pending. Such a requirement has been in effect through the purchase gas adjustment (PGA) passthrough rule of the Commission. The FERC has been reviewing the rates of each pipeline at least every three years for over a decade. Many pipelines in fact file much more frequently.

However in a time of decreasing costs a pipeline may not want to have its rates reviewed. Additionally, as pipelines are no longer the primary sellers of gas, they are beginning to suspend their PGA passthroughs. The existing three-year rate case filing requirement only applies if the pipeline has a PGA in effect. But pipelines' rates should still be subject to a periodic review. NASUCA submits that such review is essential to the Commission's function of protecting consumers from excessive rates. It provides a needed balance to the utility's dominant market position. At the sane time, it does not jeopardize a pipeline's opportunity to earn a fair return.

In conclusion, NASUCA strongly supports S. 933. It provides a balance that has been lacking in the FERC's ability to carry out its duty, namely to ensure rates that are fair to ratepayers. It fills a need that has been met on the electric side of federal regulation. This imbalance has been recognized for years, by courts and by the Commission. We urge favorable action on this bill and would be happy to cooperate in working on any minor wording changes that may facilitate its passage.

Thank you for your consideration of this important and necessary bill.

[Attachments.]

(Resolution 1989-2)

Resolution Urging the Congress of the United States to Enact a "Regulatory Fairness Act" for Natural Gas

WHEREAS, Under Section 4 of the Natural Gas Act (NGA) a natural gas utility filing for a rate increase at the Federal Energy Regulatory Commission (FERC) may put the rate increase into effect subject to refund no later than five months after the filing, which is in most instances many months or even years before the FERC determines whether the increased rates are just and reasonable;

WHEREAS, Natural gas consumers must pay the increased gas rates in effect subject to refund during the pendency of a rate proceeding at the FERC pursuant to NGA Section 4;

WHEREAS, Under Section 5 of the NGA rates found to be excessive or unreasonable by the FERC may be reduced only prospectively;

WHEREAS, Under Section 5 of the NGA an affected gas customer or consumer who files a complaint at the FERC alleging that the rates of a natural gas pipeline are unjust and unreasonable must continue to pay the rates until the final determination of the complaint and will never receive a refund of amounts paid under unjust and unreasonable rates prior to a final determination by the FERC;

WHEREAS, When the FERC on its own initiative sets for hearing under NGA Section 5 the reasonableness of existing rates and subsequently determines that a pipeline has been charging unjust and unreasonable rates, consumers receive relief only prospectively and are entitled to no refunds of excessive amounts paid during the pendency of the proceeding;

WHEREAS, In 1988 the Congress enacted the Regulatory Fairness Act (PL 100-473, supported by OCC GB Resolution 87-25) which amends the Federal Power Act of 1935 to provide that rates of an electric utility will be subject to refund during the pendency of a proceeding at the FERC to determine the reasonableness of that utility's rates or practices;

WHEREAS, Under the Regulatory Fairness Act of 1988 consumers may receive refunds of excessive amounts paid under rates subsequently found to be unjust and unreasonable;

WHEREAS, The FERC is utilizing the Regulatory Fairness Act of 1988 to make electric rates subject to refund pending investigation and hearing;

THEREFORE BE IT RESOLVED that the National Association of State Utility Consumer Advocates (NASUCA) calls upon the Congress of the United States to enact legislation for natural gas regulation to parallel the Regulatory Fairness Act of 1988, entitling consumers to refunds if natural gas rates and practices are found to be excessive, unjust or unreasonable;

BE IT FURTHER RESOLVED, that NASUCA directs the Gas Committee to mail a copy of the foregoing resolution to each FERC Commissioner;

BE IT FURTHER RESOLVED, the NASUCA directs the Gas Committee to mail a copy of the foregoing resolution to the respective Chairmen and Members of the U.S. House of Representatives Committee on Energy and Commerce and U.S. Senate Committee on Energy and Natural Resources; and

BE IT FURTHER RESOLVED, that NASUCA authorizes the Executive Committee to develop positions and take further actions consistent with the contents of this resolution. The Executive Committee shall inform the membership of such positions and actions prior to proceeding with them, if at all possible. In any event, the Executive Committee will advise the membership of any actions taken consistent with the recommendations contained herein.

Approved by NASUCA: Columbus, Ohio, June 15, 1989.

Submitted and Favorably Reported by: NASUCA Gas Committee, June 14, 1989.

(Resolution 1991-11)

RESOLUTION OPPOSING LEGISLATION ABOLISHING THE FEDERAL ENERGY REGULATORY COMMISSION AND TRANSFERRING ITS DUTIES TO AN ADMINISTRATOR REPORTING TO THE SECRETARY OF ENERGY AND AFFIRMING THE NEED FOR CONTINUED REGULATION OF INTERSTATE PIPELINES AND THE PERIODIC REVIEW OF THE RATES OF INTERSTATE PIPELINES

WHEREAS, Legislation currently proposed in Congress would: (1) eliminate the Federal Energy Regulatory Commission (FERC) as an independent commission within the Department of Energy and transfer its statutory powers and duties to a single administrator reporting directly to the Secretary of Energy; (2) deregulate pipeline sales and transportation rates where pipelines' gas markets are found to be sufficiently competitive; and (3) eliminate the triennial review of pipeline rates; and

WHEREAS, The FERC must allow only just and reasonable rates to be charged for interstate natural gas pipeline services and the triennial review of pipeline rates provides for periodic investigation of their justness and reasonableness; and

WHEREAS, The FERC must base its decisions regarding just and reasonable rates on record evidence, affording rights of due process to all affected parties; and

WHEREAS, The purpose of regulation under the Natural Gas Act is to protect consumers from abuse of monopoly power; and

WHEREAS, A finding by the FERC of competition in a pipeline's gas markets does not necessarily prevent the pipeline from exercising monopoly power in specific situations; and

WHEREAS, The deregulation of pipeline rates in competitive markets will have a negative impact on non-competitive markets in which pipelines provide service; and

WHEREAS, The Department of Energy should not be provided with the conflicting goals of balancing the interests of shareholders, producers and customers with the goal of promoting various uses of energy; and

WHEREAS, The current structure of the Federal Energy Regulatory Commission allows for a diversity of regional interest to be represented in the Commission's makeup which diversity would be lost by placing the Commission's responsibilities under the Secretary of Energy;

THEREFORE, BE IT RESOLVED that the National Association of State Utility Consumer Advocates (NASUCA) calls upon the United States Congress to reject legislation transferring the powers and duties of the Federal Energy Regulatory Commission to an administrator reporting to the Secretary of Energy and to affirm the need for continued regulation of interstate pipelines under Natural Gas Act principles, including the periodic review of the rates of interstate pipelines;

BE IT FURTHER RESOLVED that NASUCA authorizes the Executive Committee to develop specific positions and to take appropriate actions consistent with the terms of this resolution. The Executive Committee shall advise the membership of any proposed action prior to taking such action if possible. In any event, the Executive Committee shall notify the membership of any action taken pursuant to this resolution.

Approved by: NASUCA Seattle, WA, May 21, 1989.

Submitted by: NASUCA Gas Committee.

Senator WIRTH. Thank you very much.

Just a summary. As I listen to this, I find the following. We are in a situation where prices are already very low. I think one of you brought that out. I mean, natural gas is pretty much in the pipeline, and it is difficult for me in that situation to imagine a lot of people being gouged. Maybe they are, but I am not sure that we have heard that this is in fact the problem.

I think that there is also, from what I understand, increasing competition in the pipelines, and in order to keep gas moving the pipelines are charging or using discounted rates to keep—and so in fact rates are going down rather than up.

It is a little unclear to me also what the legislation does. We heard oral testimony to one thing, and I guess the bill says something else. It is my understanding that on the section 5 proposals of Senator Metzenbaum that even NARUC went on record against that, and there were 4 voting for it and 13 voting against it, to have that complaint procedure changed, so the regulators themselves are suggesting that maybe there is not a problem.

Finally, Senator Domenici, I come back more to the issues that you and I have been so concerned about. One of the items that we want to do is to bring more gas to market, rather than to, it seems to me, introduce greater uncertainty, and if I am listening to what Salomon Brothers had to say in looking at your examination—I am sorry, Goldman Sachs—it seems to me the pipelines are not in the greatest financial condition to do the kinds of things that I understood we were trying to get them to do.

So I am finding myself—it is an interesting kind of question. Maybe I have learned more with the 45-month phenomenon that you were describing to us, Mr. Madden, than anything else. That is almost as long as a Senate term, Senator Shelby.

[Laughter.]

Senator WIRTH. Senator Domenici.

Senator DOMENICI. Well, Mr. Chairman, I agree wholeheartedly with you, and when I refer to Salomon Brothers, I will not slip, because I have Salomon Brothers' analysis as of February 6, and they concur rather wholeheartedly with what you have said here, Mr. Olson, indicating that—I regret to tell you, but if you were going to buy stock in a pipeline, this says buy it in Canadian pipelines, not American pipelines, as I understand it.

The reasons are precisely what we are talking about. They have a degree of certainty where we have manifold opportunities for uncertainty among our pipelines, including the enormous length of time it takes to finally terminate contentious matters.

I would say, for the pipeline companies who are here obviously seeking not to have this particular change occur, that you might benefit, pipelines, from reading what Salomon Brothers has to say about Canadian Gas and the Iroquois pipeline and the rolled-in prices.

They seem to indicate that the Senator from Colorado and the Senator from New Mexico are right that the Canadians are receiving a very big advantage, because rolled-in prices that they use in Canada create a different pricing mechanism than we use, and it looks like you are getting a bargain. That is how I read the report, and I would ask that it be made a part of the record.

Senator WIRTH. Without objection.

[The information referred to follows:]

Stock Research
Petroleum Exploration & Production
Salomon Brothers

February 6, 1991

Thomas R. Driscoll, CFA
(212) 747-2107
Jay R. Wilson
(212) 747-5239

TransCanada PipeLines — Rapid Expansion Should Lead to Strong Earnings and Share Price Gains; Coverage Initiated With O Code

TRP-TSE[a] (153.9 Million Shares; C$2.6-Billion Market Value of Equity)

	EPS Curr.	EPS Prev.	P/E	P/E Rel. to TSE 300		Other Data	
Act. 1990	C$1.23	—	14.6-11.7	1990 Range	74%-79%	Price (4 Feb)	C$16 5/8
Est. 1991	1.40	—	11.9	1991	89	52-Wk. Range	C$18-C$14 3/8
Est. 1992	1.70	—	9.8			Dividend	C$0.72[b]
						Yield	4.3%

	Quarterly Earnings Per Share 1Q	2Q	3Q	4Q	Year
1990A	C$0.32	C$0.30	C$0.30	C$0.31	C$1.23
1991E	0.35	0.35	0.35	0.35	1.40[c]
1992E	0.43	0.42	0.42	0.43	1.70[c]

	Cash Flow From Oper. Mils.	Cash Flow From Oper. Per Share	Price/Cash Flow Ratio
1990A	C$279	C$1.80	9.9-7.9
1991E	332	2.00	8.3
1992E	458	2.55	6.5

Investment Code: Current: O C$17/3328

[a] TransCanada also is traded on the New York Stock Exchange under the same symbol. [b] Before 15% Canadian withholding tax on nonresidents. [c] Rounded to the nearest C$0.05 per share.
E Estimate A Actual
Note: All figures are stated in Canadian dollars except where noted.

Summary and Investment Opinion

We are initiating coverage of TransCanada PipeLines (TCPL) with an O investment code.

An aggressive expansion program to meet fast-rising North American natural gas demand has begun after several years of lackluster growth. This should lead to rapid, low-risk earnings growth over the next few years. Growing earnings from the regulated Canadian "mainline" — comprising over three-quarters of TCPL's net assets and contributing 69% of 1990 net income — likely will be the primary driving force behind the strong earnings growth. Our 12-month target price is C$20 per share, equal to 11.8 times our 1992 earnings estimate.

- **Earnings per share probably will grow by 15%-20% annually over the next two years.** We expect earnings to rise from C$1.23 per share in 1990 to C$1.40 per share in 1991 and C$1.70 in 1992. Earnings from continuing operations were C$1.18 in 1989.

- **Rising North American natural gas demand should drive strong growth.** Canadian gas supplies are likely to play a major role in satisfying rising U.S. natural gas demand — especially in the gas-starved mid-Atlantic and New England states — over the next several years. The willingness of Canadian producers to make long-term commitments gives them an advantage over U.S. producers in securing gas sales agreements. As the only major Canadian gas pipeline east of Alberta, TransCanada is well positioned to benefit from this growth.

Affiliated Pipelines. The company has ownership interests in several affiliated pipelines that connect to its mainline and serve U.S. and Canadian markets. The largest of these investments is its 30% interest in Northern Border Pipeline, which serves the upper Midwest. Its other major pipeline investments include a 50% interest in Great Lakes Transmission Co. and a 44% interest in the Foothills Pipeline, which delivers gas to Northern Border at the Saskatchewan-Montana line. Iroquois Gas Transmission, in which TransCanada has a 29% interest, is scheduled to begin moving gas in November 1991 and should reach full capacity of 576 mmcfpd in November 1992. The total equity invested in the associated pipelines and projects totaled over C$400 million at the end of 1990, nearly C$3 per share.

Western Gas Marketing. This wholly owned affiliate makes only a small direct impact on income; however, the services that it provides are vital to the company's continued growth. Western administers the company's gas purchase contracts with Alberta gas producers and has been essential to the company's efforts in securing additional export markets. The company purchases nearly one third of all Canadian gas production.

BCE's Sale of Its Ownership Interest. TransCanada's major shareholder announced in September 1990 that it would sell its 48.8% interest in the company. In October, BCE Inc. sold units for C$17 each, consisting of one share of TRP and one warrant (entitling the holder to buy one additional share from BCE until December 15, 1992 for a price of C$17.50 per share). BCE reduced its ownership interest from about 48.8% to 24.5% with the sale. The exercise of all the warrants virtually would eliminate BCE's shareholding.

The North American Natural Gas Market

The export market is very important to TransCanada, and its contribution will become even more meaningful to the company with the completion of the Iroquois line. Canada currently supplies about 7% of U.S. gas demand, representing about one third of Canadian gas production. We believe that Canadian gas producers will supply as much as 10% of U.S. demand over the next three to five years. The importance of the U.S. market can be illustrated by noting that a 1% increase in Canadian producers' share of the U.S. market would equal a 15% increase in Canadian production.

About [illegible] bcf of gas currently flows through TransCanada's lines to U.S. markets annually. This is about 2½% of U.S. demand and was 30% of TransCanada's 1990 deliveries. We expect Canadian imports to garner an increased share of the U.S. markets over the next several years, and this will provide attractive opportunities for TransCanada.

- **Canadian export pipeline capacity is limited.** Canada's ability to increase its gas exports is constrained by a lack of available pipeline capacity. Exports in 1990 approached the pipeline capacity of about 1.5 tcf. Exports possibly could increase to 2.0-2.5 tcf annually if sufficient pipeline capacity were in place. The construction of the Iroquois system will increase export capacity by about 200 bcf annually, while the Niagara import project should add another 100 bcf annually.

- **Canada's domestic regulatory environment is more favorable than that in the U.S.** The NEB regulates TransCanada's Canadian pipeline operations. The regulatory regime virtually guarantees that TCPL will be able to earn its allowed rate of return. In contrast to U.S. regulation, TCPL is entitled to recover all of its fixed operating costs, interest costs and return on equity through fixed charges. Therefore, variations in throughput volumes do not impact earnings. This is an important difference, compared with U.S. pipeline regulation. In the United States, pipelines generally are at risk for at least part of their fixed cost recovery. A portion of fixed costs is recovered through a volumetric charge. Under U.S. regulatory rules, if throughput volumes are less than expected, earnings likely will be disappointing.

- **Take-or-pay settlements have been financed by the producers.** In contrast to large writedowns taken by U.S. pipelines related to gas contract settlements and take-or-pay clauses, TransCanada has avoided any negative earnings impact related to gas purchase contract settlement or renegotiation. From 1977-83, the company made significant take-or-pay payments to producers. Advances of C$2.7 billion initially were financed in 1982 and 1983 through arrangements with a banking syndicate. In return, those producers agreed to reduce TCPL's minimum natural gas purchase obligations substantially. Recovery of the advances is being made upon delivery of the prepaid gas over a period ending in 1994. If the proceeds of the gas sale are less than the amount advanced, the producers (not TCPL) must make up any deficiency. Interest costs are being recovered from the producers. TCPL has provided the lenders with indemnities against losses arising from the failure of the producers to deliver the prepaid gas. Indemnities provided by TCPL totaled approximately C$91 million as of December 31, 1990.

Mainline Earnings are Very Predictable

We expect mainline earnings to grow dramatically over the next several years, directly resulting from the aggressive capital spending program currently underway. We expect mainline common-equity earnings to more than double between 1990 and 1993 from C$128.4 million in 1990 to about C$270 million in 1993.

Throughput is rising rapidly. Throughput rose by 6% in 1990, compared with 1989. Three quarters of the gain was due to increased deliveries to midwestern and northeastern U.S. markets. This rise follows a 5% increase in volumes in 1989. During 1989, export volumes were up by 15%, while domestic deliveries rose by 2%. Deliveries climbed 17% in 1988, reflecting a 71% increase in export volumes. While growing throughput does not impact current income, over time, growing demand for additional capacity will lead to expansion of the company's rate base and higher earnings.

Earnings from the "mainline" are set by only three variables. These variables are the allowed return on equity (currently set at 13.25%), the size of the rate base (which should more than double over the next three years) and the portion of the rate base that is deemed to be equity. Earnings are not impacted by the weather, throughput or changes in gas demand or gas prices. The regulatory scheme in Canada results in lower risk to the company and the ability to carry a lower equity component than would be wise with U.S./style regulation (which ultimately benefits ratepayers with lower rates).

Mainline earnings are easily forecast. As the mainline earnings essentially are determined by the rate base, capital structure and the allowed returns, they are highly predictable and easily modeled.

- **Aggressive expansion on the mainline is planned.** TransCanada is awaiting final approval by the NEB of a $2.6 billion (Canadian) facilities expansion plan. If the proposed projects are approved, the rate base — on which the pipeline is allowed to earn a return — likely will more than double between 1990 and 1993 from C$3.0 billion to over C$6.0 billion. Both common equity and debt financing will be required to fund the expansion. Current shareholders should benefit from increased earnings on a fast-rising book value as new shares are issued.

- **Canadian pipeline regulation is low risk and virtually assures that allowed returns will be earned.** TCPL's ability to recover its operating costs and earn its allowed rate of return basically is assured by the Canadian regulatory rules. TransCanada has been able to earn a 13.25%-13.75% return on equity in the mainline over the past several years. It has filed for a 14.5% return on equity in 1991. Our earnings estimates reflect a 13.5% return on equity.

- **Recent project approvals have been received.** The recent approval by the U.S. Federal Energy Regulatory Commission (FERC) of the Iroquois Project — expected ultimately to deliver 576 mmcfpd of natural gas to the Northeastern U.S. — and the approval of "rolled/in" tolls on TransCanada's mainline (which lead to lower and thus, more competitive delivered gas costs than an incremental tolling system would have) by the Canadian National Energy Board (NEB) have brought TCPL's expansion plans one step closer to reality.

- **Earnings from equity interests in associated pipelines should grow as additional expansion projects take place.** Earnings from TCPL's equity interests in pipelines and projects that provide access to related (primarily U.S.) natural gas markets should grow by about 70% over the next three years. TransCanada's investment in associated pipelines and projects totaled over C$400 million at year-end 1990. The most important of these investments are those in Northern Border Pipeline, the Great Lakes system and the Iroquois project.

- **Other gas-related energy projects will contribute to earnings growth.** TCPL probably will continue to make opportunistic investments in related businesses. Examples of these investments include the 40% ownership interest in Ocean State Power — a US$460 million, 500 mega-watt combined-cycle facility in Rhode Island — and Nipigon, a 36 mega-watt power plant to be built by the company adjacent to an existing compressor station in northern Ontario. Future investments could include additional Ontario power projects, natural gas storage facilities or perhaps U.S. pipeline investments.

Company Description

TransCanada PipeLines Ltd.'s major asset is its Canadian mainline system, which runs from Alberta across four provinces to Quebec. Other important assets are its equity interests in several affiliated pipelines and its wholly owned affiliate, Western Gas Marketing Limited.

The "mainline". The mainline is the only major gas transporter in Canada east of Alberta. Subsequent to the spin-off of Encor to shareholders in May 1989 (Canada's twelfth largest oil and gas company), about 80% of the company's noncorporate assets relate to the pipeline.

After several years of very modest capital expenditures and a small decline in the value of the gas transmission property, capital spending rebounded dramatically in 1989. The pipeline has aggressive expansion plans to take advantage of the resurgence in North American natural gas demand.

Capital spending has increased dramatically. Increased opportunities, presented primarily by a resurgent U.S. gas market, have led to an ambitious series of pipeline expansion projects. After a period of lackluster spending (capital spending averaged C$99 million from 1985-88), capital spending increased sharply in 1989. It reached C$671 million in 1989 and C$482 million in 1990. TransCanada plans to spend nearly C$3 billion in 1991 and 1992. Facility additions over the four-year period ending in 1992 should expand total capacity by 1.5 billion cubic feet per day (bcfpd), compared with 1989 deliveries of 3.9 bcfpd.

The rate base is rising briskly. The approved rate base increased from C$2,360 million in 1988 to C$2,520 in 1989 and C$3,033 million in 1990. The company has filed for an average rate base of C$3,859 million in 1991. By 1993, the rate base should rise to over C$6,000 million — twice the 1990 level.

A 14.5% return on common equity has been requested for 1991. We expect that the company will be allowed to earn a return on equity that is slightly better that the 13.25%-13.75% returns that have prevailed for the past several years. We believe that the need to attract substantial equity capital to finance the aggressive expansion plan-justifies a somewhat higher return, but our model reflects a 13.5% return on equity.

Common equity has been set at 30% of mainline capitalization. In recent years, the company has been allowed to earn on a 30% deemed common equity ratio on its investments in the mainline. We expect this level to continue over the next several years. It is lower than typical equity levels carried by U.S. pipelines, but in our opinion, the lower level of earnings risk under Canadian regulation justifies a more highly leveraged balance sheet. Our model reflects the assumption that preferred equity will remain near 10% of capitalization and that debt will remain about 60%.

Valuation; Our 12-Month Target Price is C$20 Per Share

Rapid earnings growth of 15%-20% annually in 1991 and 1992 likely will drive the shares higher. Our 12-month target price of C$20 per share is based on our belief that the shares should command a price of nearly 12 times estimated 1992 earnings of C$1.70 per share. This estimated share appreciation, combined with a 4.3% current yield, should provide investors with an attractive return.

The majority of TCPL's income is from the mainline, which is subject to fixed rate-of-return regulation in Canada. Almost all of the remaining income is derived from U.S.-based natural gas pipelines. An appropriate peer group of Canadian pipelines does not exist. However, a group of Canadian gas utilities trades at an average of 11 times 12-month forward earnings estimates, and a group of Canadian electric utilities trades at 10 times. The most appropriate comparison in the U.S. probably is a group of local gas distribution companies (LDCs). These companies have similar characteristics in terms of regulatory and earnings risk. A group of U.S. LDCs trades at an average of 11-12 times 1991 earnings estimates.

We believe that it would be less appropriate to compare TRP's P/E multiple with that of U.S. gas pipelines (which trade at 14 times estimated 1991 earnings) because of the differing business risks, depressed U.S. pipeline earnings levels and TRP's near certainty that it will earn its allowed rate of return. Similarly, close reliance on an historical price earnings relationship for TRP would be misleading since the 1989 spinoff of the oil and gas company has reduced the company's business risk substantially. TransCanada's P/E ratio has varied from a 100% premium to the TSE 300 to a 60% discount over the past ten years. The TSE 300 currently trades at about 13 times 1991 estimated earnings.

* * * * *

Salomon Brothers Inc makes a market in the convertible securities of TransCanada PipeLines. Salomon Brothers Inc actively trades in the securities of TransCanada PipeLines for customers' accounts and for its own accounts. Salomon Brothers Inc also may issue options on the securities of TransCanada PipeLines and may trade for its own accounts in options that have been issued by others. We, accordingly, may at any time have a long or short position in any such security or in options on any such security. As of February 5, 1991, the Firm has no positions in the common shares of TransCanada PipeLines.

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Salomon Brothers Inc

New York	(212) 747-7000
Atlanta	(404) 827-7600
Boston	(617) 357-6200
Chicago	(312) 876-8700
Dallas	(214) 880-7300
Los Angeles	(213) 253-2200
San Francisco	(415) 951-1777

Frankfurt

Salomon Brothers AG
49-69-2607-0

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Salomon Brothers Asia Limited
81-3-5255-4111

Toronto

Salomon Brothers Canada Inc
(416) 866-2300

Zurich

Salomon Brothers Inc
41-1-366-4111

Representative Offices

Berlin	49-34-782-3077
Madrid	34-1-410-3000
Melbourne	61-3-670-7555
Seoul	82-2-358-0587
Singapore	65-255-6186

U B B
(15-95)

Senator **Domenici**. I would indicate to those here that it is a complex issue, and I would only say to you, Mr. Fuller, that you indicated—and I greatly appreciated your theory—that we should not be afraid of our commissions, whether it is yours in California or ours. We are not afraid. It is just that sometimes you wonder how long it takes them to get the job done.

But I would also ask—you know, you said, if you are going to have these periods of adjudication and have 5 months or 7 months or 8 months, you indicated that the pipelines ought not to be able to collect.

On the other hand, I assume that you would conclude that if the pipeline is correct, they ought to go back to zero time and collect, would you? That would go both ways, or would you have the consumer pay only at the end of the time?

Mr. **Fuller**. The equity should cut both ways.

Senator **Domenici**. I think that seems fair, if you are operating off this premise of one is certain and right and the other is obviously uncertain and wrong, which I gather is really not the case, but rather, it is very muddled up and clouded.

Mr. **Fuller**. Your proposition there is exactly the way I think virtually all of the 50 State commissions work, and it sometimes takes a year or two for our rate cases to be adjudicated. In that time, we are at risk. We continue to deliver product at the old rate, the lower rate, but we are at risk for that year or two, until that commission decides that the rate we proposed is just and reasonable.

Senator **Domenici**. What do you mean, you are at risk?

Mr. **Fuller**. We are much more capital intensive than pipeline companies, and I would think Mr. Olson even would agree with that.

Senator **Domenici**. What do you mean, you are at risk?

Mr. **Fuller**. We are at risk for our investment.

Senator **Domenici**. Well, of course, but what happens when they finally adjudicate the rate?

Mr. **Fuller**. We are better or worse off.

Senator **Domenici**. Does it go back to the time you applied for it, or does the rate apply to the time that it was adjudicated?

Mr. **Fuller**. Well, the rate, if it is an increase, applies at the time the decision is made, all right, so we do not recover. If the rate is a decrease, it goes back and you refund to your customers.

Senator **Domenici**. That is what I was asking. What is the logic of one and not the other? What is the logic of not charging the rate increase as of the time you applied?

Mr. **Fuller**. There is none. I would entirely agree with you.

Senator **Domenici**. Nonetheless, it is applied.

Senator **Wirth**. Senator Shelby.

Senator **Shelby**. Thank you. My knowledge is that there is competition in the energy field. When we talk about consumers, which we all are consumers, if natural gas were priced—if you priced yourself out of the market, there are other alternatives out there.

I do not know any of us that are totally captive. We might have to change a little bit, but there is electricity there. There are other things, and if you price yourself out of the market you lose market share. That is basically economics.

This is something that is bothering me about the whole thing, and that is the idea of uncertainty. I want to address this, Mr. Olson, to you, because you are in the capital markets and so forth. You have got to have predictability, have you not, when you are investing in any industry, to acquire tremendous capital?

Mr. OLSON. There is no question about it, especially in the capital markets—the bond markets, the long-term sector.

Senator SHELBY. This is what you are talking about when you are dealing with the pipelines that transport large quantities of gas in this country?

Mr. OLSON. Yes, and for instance, I wish I could be as optimistic as perhaps Ms. Samuels about the outlook for pipelines, but Panhandle Eastern, as we talk, is now trying to raise equity capital. They are selling at below book value.

I do not know that anybody likes to sell below book value, but they are forced into that position because they are only earning 5 percent on their equity, and they are 70 percent leveraged, and they are underearning on 70 percent of their rate base. This is not a happy confluence of circumstances.

We have also seen bond ratings come down, if I can quantify it, by about 20, 25 percent over the past 5 or 6 years. About 14 out of 16 pipelines with ratings right now have triple B's. That is one step ahead of speculative grade, if you go into double B's you go into a Bermuda Triangle of junk bonds. You get priced out of the market, if you will, and on top of that, just the erosion in ratings has created maybe a 100 or 200 basis point increase in consumer cost, just due to rising interest expense.

Senator SHELBY. Just the cost of doing business, is it not?

Mr. OLSON. I could go on for an hour about how the returns on equity have been cut in half over the last 5 or 6 years as a result of all of these partial deregulation programs. I will not bore you with all of the——

Senator SHELBY. I think this is important. I think it is central to this proposed piece of legislation.

Mr. OLSON. Well, in terms of this refund provision I would like to look for a smoking gun out there. If these refunds had benefited the pipelines you certainly do not see it in returns on equity of 4, 5, or 6 percent. Those are what are known on Wall Street as chopped liver—and elsewhere.

The erosion has been pronounced. Is there any wonder, now, that we have seen one pipeline go into bankruptcy, which is United? They are being financed $300 million by a short-term debt, zero equity in the company.

Perhaps the biggest casualty of the open access programs, Columbia today not only announced they were going to cut their dividend but they are considering filing Chapter 11 as a result of the consequences of some of the past practices. Whether smart or dumb, I am not prepared to tell you right now.

I think we are looking at a business which has been under very severe strain on Wall Street. For openers, in the past 7 months we have had one of the biggest stock market rallies in the last 50 years. The market is up about 26 or 27 percent. Pipeline stocks are down 6 percent.

Senator SHELBY. Why are they down, because of the price of gas?

Mr. **Olson**. No. The price of gas does not have much bearing on the fortunes of pipelines.

Senator **Shelby**. Why are the stocks down?

Mr. **Olson**. I think it is a combination of a loss of investor confidence in the outlook for the business. I think investors have been chewed up a little bit too much by all of the consequences, the after-shocks of the deregulation programs. They can find much better returns elsewhere than 5 or 10 percent on equity with much less risk.

Senator **Shelby**. What would the Metzenbaum proposal, if it were to ever become part or become law, what would that do? Let us go back to the issue. Would it breed more uncertainty?

Mr. **Olson**. I think I could promise you it would breed more uncertainty. It creates kind of an event risk, which is something that came out of the LBO vintage of bonds and financings.

If you give me a situation where there is a major retroactive refund developed from busting the last clean rates there, Wall Street will clearly reprice the securities into much higher rate levels, and I think the various rating agencies would downgrade the rates, too.

It would take maybe one or maybe two of these so-called accidents to happen, and we would be in for some more turbulence.

Senator **Shelby**. Mr. Kuehn, you in your testimony, among other things—written testimony—you alluded to that there has got to be a balance, or there should be a balance in the regulatory scheme, a balance where you get the pipelines to get a fair return.

On the other hand, the consumer gets something, too. We are all consumers, including yourself, everybody at the table. I have not had a deluge of letters, calls, or mail, about the consumer raising Cain about this in my State. Maybe it occurs somewhere else.

Maybe you have got better information than I do today, but I will tell you, when the consumer, or my constituents, are upset and they feel like they are being gouged, or they feel like they are being overpriced, we are going to hear from them, and I have not been hearing from them, and I wonder if that says anything? Ron, do you want to comment?

Mr. **Kuehn**. Well, I think, Senator, you alluded to the increased competition in the business, and there is tremendous competition in the business—electricity, fuel oil, other pipelines, open access.

Mr. Olson has referred to the rate of returns of a pipeline industry which have gone down, down, down, and they have gone down primarily because of the open access transition, which has encouraged further competition.

You have pipelines in the situation where they are in the vise between regulation and S. 933 would throw another layer of regulation on top of what we have already got, plus FERC forcing the pipelines into a more competitive position, and when you have increased competition lowering the rates on the bottom side, but regulation capping the rates on the top side, you end up with the type of returns Mr. Olson is talking about.

Over the long term you cannot expect an industry which is experiencing that kind of financial erosion to be a main player in building still new pipe and making still greater investments in order to expand natural gas markets. Now, nobody in their right mind is going to make the huge investments necessary to meet those goals if they do not know how much they are going to make in the future, more or less, let alone not know how much they are going to be allowed to keep from what they earned in the past, which is at risk under S. 933.

We need more rate stability than we have now. We need better rates than we have now, clearly. Five percent return on equity, you can go to your S&L, pardon the expression, and do better than that.

So I see S. 933 as unnecessary and a major step backward, and a major impediment to what you are trying to accomplish in the national energy strategy.

Senator **SHELBY**. Mr. Chairman, thank you for your indulgence.

Senator **WIRTH**. Thank you, Senator Shelby, and thanks to all of you for being here, and we will leave the record open for the next week for any further comments that you all might like to make.

We greatly appreciate your being here. The committee may have follow-up questions for you.

[Whereupon, at 3:25 p.m., the hearing was adjourned.]

APPENDIXES

APPENDIX I

Responses to Additional Questions

DEPARTMENT OF ENERGY,
CONGRESSIONAL AND INTERGOVERNMENTAL AFFAIRS,
Washington, DC, August 1, 1991.

Hon. TIMOTHY E. WIRTH,
Chairman, Subcommittee on Energy Research and Development, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: On June 19, 1991, Mark C. Schroeder, Deputy General Counsel testified before your subcommittee on S. 933, the Natural Gas Ratepayers Relief Act of 1991.

Following the hearing, you submitted one written question to supplement the record. Enclosed is the answer to that question.

If we can be of further assistance to you or your staff, please contact our Congressional Hearing Coordinator, Renee Wilhite, on (202) 586-4277.

Sincerely,

JACQUELINE KNOX BROWN,
Assistant Secretary.

[Enclosure.]

Question. You testified that enactment of S. 933 would be counterproductive to the objectives of the National Energy Strategy and S. 1220, the National Energy Security Act of 1991, reported by the Energy Committee. Would you please explain in greater detail why this would be the case.

Answer. Section 2(a) of S. 933 would amend section 4(e) to provide that, after it has determined the "just and reasonable" rate, FERC may order a natural gas company to refund all amounts that represent the difference between the "just and reasonable" rate and the rate collected by the natural gas company after the natural gas company's proposed rates became effective. FERC may set the "just and reasonable" rate at a level that is substantially lower than the previously approved rate; therefore, under this amendment, a natural gas company would be completely unable to predict the extent of the refund liability to be incurred during the pendency of its rate case, which may last from two to five years.

Section 2(c) of S. 933 would amend section 5 to authorize the FERC to order a natural gas company to refund any amounts collected in excess of the rate that is found to be just and reasonable subsequent to the "refund effective date." The refund effective date would be set by the FERC.

In the case of a hearing instituted upon complaint, the amendment would limit the refund effective date to a date not earlier than 60 days after the filing of the complaint. There is no such limitation upon the refund effective date in the case of a hearing instituted by the Commission. Thus, in the case of a hearing initiated by the Commission, the liability of a natural gas company for refunds of rates collected in the past would be unlimited; FERC would have the authority to reach back for years to retroactively review all rates charged by a natural gas company under the NCR, despite the fact that those rates were approved by the FERC itself.

One of the principal goals of the National Energy Strategy with respect to natural gas, as well as title XI of S. 1220, is to encourage and facilitate the construction of new pipeline capacity by removing regulatory uncertainty. If pipelines may be required to provide refunds on rates previously found by FERC to be just and reasonable rates, the stability and predictability necessary to induce new capital investment in facility modernization and expansion will be lacking. Even if financing can be obtained, uncertainty is perceived as risk in the capital markets, and added risk carries with it additional financing costs.

The increasing amount of competition in natural gas markets generally provides an incentive for pipelines to modify their rates to remain competitive. However, exposing pipelines to unlimited liability under section 4 will discourage pipelines from making new rate filings. Pipelines will have an incentive not to file for new rates under section 4, leaving it to the Commission or other complainants, who then also are given by statute the burden of proof, to seek lower rates. The National Energy Strategy recommends elimination, not creation, of regulation that promotes rigidity and lack of market responsiveness in the natural gas industry.

FEDERAL ENERGY REGULATORY COMMISSION,
OFFICE OF PIPELINE AND PRODUCER REGULATION,
Washington, DC, July 19, 1991.

Hon. TIMOTHY E. WIRTH,
Chairman, Subcommittee on Energy Regulation and Conservation, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: Enclosed are my responses to questions for the record of your Subcommittee's June 19, 1991, hearing on S. 933, the "National Gas Ratepayers Relief Act."

If you have any further questions or need additional information, please let me know.

Sincerely,

KEVIN P. MADDEN,
Director.

[Enclosure.]

Question 1. Three-Year Rate Restatement: S. 933 proposes to amend Natural Gas Act (NGA) section 4 to require pipelines to refile their tariffs every three years, while the Regulatory Fairness Act did not amend Federal Power Act (FPA) section 205 to make electric utilities subject to a similar three-year filing requirement.

(a) What was the original purpose of the three-year rate restatement requirement in the Commission's purchased gas adjustment (PGA) regulations?

(b) As pipelines move away from using PGAs to recoup their gas costs, is there any reason to retain a three-year rate restatement requirement?

(c) Would a statutory three-year rate restatement requirement frustrate any of the Commission's efforts to reform the rate process? What about gas inventory charges (GICs)? What about incentive rates?

Answer 1(a). The Commission adopted its PGA regulations in 1972 to curb the frequency of general rate increase applications and the resulting uncertainty caused by administrative delays. At the time, most pipeline companies were primarily merchants, and they purchased natural gas for resale to local distribution companies and end users. Purchased gas costs represented the largest single component of most pipeline companies' cost of service; and gas wellhead prices were rapidly increasing. As a trade-off for allowing pipelines to "track" gas costs (i.e., automatically flow through to consumers purchased gas cost increases and decreases) and potentially reducing the frequency of rate case filings, the Commission required pipelines to file at least every three years to restate their base tariff rates, in order that the justness and reasonableness of all other components of the pipelines' cost of service could be reviewed.

The Commission's responsibility under section 4 of the NGA, is to ensure that the tariffs of pipeline companies under its jurisdiction are just and reasonable and not unduly discriminatory. In addition, the Commission has authority under section 5 and other means to ensure that rates are just and reasonable. However, many pipelines, including those with PGAs, file section 4 rate cases to reflect increased costs outside the three-year restatement requirement. Indeed, the majority (85 of the 130) of jurisdictional pipelines currently use no gas tracking mechanism, and therefore, have no three-year restatement requirement. The remaining pipelines, which are usually small, either perform only transportation or storage, or have cost of service type tariffs.

Answer 1(b). The Commission's efforts to reform the rate process by relying on competitive market forces, where possible, to discipline rate levels could easily be frustrated by a statutory three-year rate restatement requirement by increasing uncertainty with respect to cost recovery, thereby reducing or eliminating pipeline incentives to operate more efficiently.

Answer 1(c). To the extent a mandated triennial base tariff rate review included a review of market-based, negotiated GIC sales rates, further progress toward the effective operation of a competitive marketplace for natural gas will be impeded. Similarly, the concept of incentive ratemaking relies on the premise that pipelines will strive to reduce or eliminate costs where possible if they are able to keep all or at least share the cost savings. The Commission recently stated that it would only consider incentive rate proposals that are based on future cost savings. Therefore, a mandated three-year rate review may not provide sufficient incentive to pipelines to reduce their costs.

Question 2. Who Ultimately May Pay the Cost: Suppose that as a result of amending NGA sections 4 and 5 costs of capital for interstate pipelines increase.

(a) Would FERC permit the pipelines to increase their rates to recover the higher interest payments as a cost of doing business?

(b) Would ratepayers have to pay these costs as part of the pipelines' rates?

(c) If as a result of amending NGA sections 4 and 5 there is an increase in rate litigation at FERC, who would have to pay for the increased litigation costs?

Answer 2(a). In most cases the Commission would permit pipelines to increase their rates to recover increased debt costs that resulted from amendments to the NGA. Pipelines are entitled to recover prudently incurred costs. The Commission has traditionally used a cost of service approach in its evaluation of whether a pipeline's rates are just and reasonable. A pipeline's cost of service generally includes all costs associated with conducting its business, including the cost of debt capital.

Answer 2(b). Yes, if the Commission allows the increased costs of capital to be included in a pipeline's rates, ratepayers would generally be required to pay the jurisdictional portion of these costs as part of their fixed charges for firm service or in the commodity charge for interruptible service. Although pipelines may be entitled to recover their prudently incurred costs, they may agree to include less than the full amount of those costs in their rates for competitive reasons.

Answer 2(c). The Commission would generally permit increased litigation costs that are the result of amendments to NGA sections 4 and 5 to be passed on to ratepayers in the form of higher rates. Like debt costs, litigation costs are part of a pipeline's cost of doing business and, to the extent that it can be shown that the costs are an ongoing cost of doing business, they are properly included in the pipeline's cost of service and its rates.

Question 3. Section 4 Rate Cases: You testified that on average it takes 45 months to litigate completely a Natural Gas Act section 4 rate cases.

(a) Please describe the steps in processing a fully litigated NGA section 4 rate case and the average time it takes to complete each step.

(b) What is the path for settled rate cases?

(c) Generally, how effective are settlements in resolving rate cases?

Answer 3(a). As I noted in my corrected testimony before the Committee, of the cases set for litigation during the last four years, 83 percent resulted in settlement. Only 17 percent were fully litigated. Review of these cases shows that the average time between the filing of a section 4 case and the issuance of an Initial Decision was 20 months. The average time from the Initial Decision to the Commission Order was 25 months.

The average 20 month period during the litigation period reflects consultation between the ALJ and interested parties as illustrated by two procedural schedules attached. (Attachments 1 and 2). The average 25 months taken by the Commission to issue orders in these cases during this period reflects, in part, a Commission priority which focused on the processing of a substantial number of filings resulting from the implementation of the Commission's open access and take-or-pay recovery programs. These programs were pursued and resolved outside of the formal rate litigation process.

In recognition of this situation, and the fact that the Commission has substantially reduced its open access and take-or-pay workload, the Chairman has established the processing of litigated rate cases as a top priority and directed staff to forward litigated cases to the Commission in a more expeditious fashion.

The processing steps in a fully-litigated rate case are set forth below:

(1) Rate Case is Filed
(2) Commission issues suspension order
(3) Discovery and Data Requests by the parties and staff
(4) Staff issues Top Sheets, its recommendations on all issues in the proceeding
(5) Testimony is filed by the parties and staff
(6) Discovery on Testimony
(7) Reply Testimony by the pipeline

(8) Hearing before an Administrative Law Judge (ALJ) is held
(9) Briefs to the ALJ
(10) Reply Briefs to the ALJ
(11) ALJ issues the Initial Decision
(12) Briefs on Exceptions to the Commission
(13) Briefs Opposing Exceptions to the Commission
(14) The Commission issues its order
(15) Parties file for Rehearing
(16) Commission issues Order on Rehearing

However, it is not possible to describe the average time necessary to complete each step. The time to complete steps 3 through 10, above, is a matter negotiated among the parties in each case. Procedural schedules are frequently modified or suspended to accommodate settlement talks among the parties. The steps and procedure in each case are unique. Attachments 1 and 2 show the various testimony dates and steps set up by the Administrative Law Judge in consultation with the Pipeline Company, Intervenors, and the Commission Staff.

Answer 3(b). Once staff has filed its Top Sheets, the parties usually engage in settlement talks with a goal of settling all or part of a rate case before testimony is filed. Once the parties have reached a settlement of a rate case, a written Stipulation and Agreement is filed with the ALJ. Comments as to whether or not the ALJ should certify the settlement to the Commission are filed with the ALJ. The ALJ must then decide whether the settlement is contested or uncontested and, if contested, whether any issues of material fact exist. If issues of material fact exist, the ALJ will not certify the settlement and the parties must reach a new settlement, develop a record that supports the settlement or go to hearing. If no issues of material fact are found, the ALJ then certifies the Stipulation and Agreement to the Commission for a Commission Order accepting, modifying or rejecting the Stipulation and Agreement. The Chairman has recently directed that all uncontested settlements are to come before the Commission no later than 45 days after certification by the ALJ.

Answer 3(c). Settlements are very effective in resolving all or part of a rate case. Settlements provide for quicker refunds and reduced rates as opposed to waiting through the full hearing process before refunds and reduced rates can become effective, thereby benefiting the ultimate consumers. In addition, settlements are important because they allow the negotiation of complex trade-offs in services and cost responsibilities. This in turn increases the efficiency of the pipeline system to the benefit of all parties.

Question 4. Statutory Time Limits for Rate Proceedings: At the hearing, it was suggested that mandatory deadlines for FERC to issue a final order in proceedings under NGA sections 4 and 5 might be a satisfactory alternative to S. 933.

(a) How would such deadlines affect FERC's processing of cases under NGA sections 4 and 5?

(b) How would such deadlines affect pipelines, producers, marketers, LDC's and consumers?

(c) What effect might such deadlines have on the proportion of rate cases that settle versus those that would be fully litigated?

(d) What actions has FERC taken, on its own, to expedite the processing of rate cases?

(e) If such deadlines were to be specified by statute, what does FERC staff believe to be reasonable time limits?

Answer 4(a). Although deadlines could be imposed, rigid deadlines might not be expeditious in every case. This is because the processing of rate cases is dependent to some degree on the number and complexity of the issues as well as the number of parties involved in the proceeding. The imposition of absolute deadlines will almost certainly affect the settlement process, and will most likely result in fewer settlements and more litigation. The parties in the proceedings cannot make themselves available to pursue lengthy settlement negotiations while they are actively preparing for litigation. Because of these time concerns, the parties generally set the procedural schedules to allow adequate time for litigation if settlement negotiations are not successful.

Also, tight deadlines can affect the adequacy of the record and thus may increase the review period and may result in more litigation after a Commission determination. The Commission's experience with establishing deadlines for the ALJ to conduct hearings has not always been successful. For example, in CNG Transmission Corp., 41 FERC ¶61,129 (1987), the Commission ordered an expedited hearing and directed the ALJ to issue a decision no later than six months after the issuance of the order establishing the hearing. However, upon review of the ALJ's initial decision, the Commission determined that the record developed at the expedited hearing was inadequate and had to direct further hearings. 46 FERC ¶61,284 (1989). Also, in Transcontinental Gas Pipe Line Corp., 36 FERC ¶61,287 (1986), the Commission remanded an $86 million "transition cost" issue for further hearing. The Commission directed the ALJ to expedite the hearing process (37 FERC ¶61,289), but upon review of the ALJ's expedited decision, had to remand the proceeding again for further development of the record. 40 FERC ¶61,232 (1987).

Answer 4(b). Mandatory deadlines could create problems for producers, marketers, LDCs, consumers and other intervenors in Commission rate proceedings in obtaining information and presenting their cases. Because of the legal and factual complexity of rate case issues, intervening parties generally must obtain information from the pipeline through the discovery process. This process can be time-consuming because of the volume and complexity of the relevant information and the need to follow up with additional rounds of discovery after preliminary information has been received and analyzed. Applying tight deadlines to this process may work to the disadvantage of these parties, thereby threatening their ability to successfully challenge the pipeline's proposed rates. These deadlines would be less likely to be a hardship to the pipeline proposing the rate, however.

Answer 4(c). To the extent deadlines would hinder the development of a full and complete record, it would work to the disadvantage of the decisional process. Under current practice, the parties agree to a schedule with the ALJ's approval to govern the litigation phase of the rate case, and this process seems to work well to accommodate the needs of the parties. To the extent tight deadlines result in more litigation and fewer settlements, the costs associated with bringing a case to closure will undoubtedly increase. Not only will the direct costs to intervenors increase, but as discussed above, increased litigation costs are costs that are generally permitted to be passed through to consumers.

Additionally, tight deadlines would probably increase the proportion of rate cases that are fully litigated versus those that settle. As noted above, parties cannot actively pursue settlement negotiations while they are answering discovery requests and preparing testimony for litigation.

Answer 4(d). Commission has made an effort to expedite the initiation and conduct of hearings in rate cases. And as noted in response to question 3(a), the Chairman has directed the staff to reduce the time between the issuance of initial decisions and the issuance of Commission decisions on exceptions to those initial decisions. The Commission also has attempted to resolve as quickly as possible issues raised in applications for rehearing of its decisions.

In addition, the Commission encourages the parties to avoid the delays of litigation by settling issues. As noted in the response to question 3(b) the Chairman has directed that uncontested settlements be acted on within 45 days from the date an administrative law judge certifies an uncontested settlement to the Commission. Further, in a recent series of orders involving the recovery of take-or-pay costs, the Commission has established settlement conferences and has assisted the parties in reaching a resolution of the issues. Further, in April 1991, the Commission also issued a Notice of Inquiry requesting comments from the industry on how best to implement the Administrative Dispute Resolution Act, whether it should revise its regulations to facilitate the use of dispute resolution techniques, and whether it should revise its settlement regulations. Finally, the Commission also, where possible, has instituted "paper hearings" in which a record is developed for decision through written submissions rather than through the more time consuming trial-type hearing with the presentation and cross-examination of witnesses.

Answer 4(e). The time necessary to develop and review a record and prepare a decision varies depending on the number and the complexity of the issues and the number of parties to the proceedings. As discussed earlier, mandatory deadlines could result in more problems than benefits, but if deadlines are to be imposed, the minimum time for reasonably completing a rate case would be between 12 and 24 months depending on the factors noted above and the other initiatives that the Commission may have ongoing at any given time.

Question 5. Section 5 Investigations: Please explain why FERC has instituted fewer rate investigations of natural gas pipelines pursuant to NGA section 5 when compared to the number of investigations of electric utility rates instituted pursuant to FPA section 206?

Answer. There are a number of reasons why FERC has instituted fewer stand alone NGA section 5 rate investigations of natural gas pipelines than it has of electric utility rates under FPA section 206. Many, if not most, recent section 4 rate cases have been filed as a result of pipelines' needs to reflect the costs of new facilities in their rates. Literally billions of dollars in new facilities have been certificated and constructed in the last several years. This has resulted in many pipelines filing rate cases prior to the three year requirement. However, for those pipelines which have not had increasing rate bases, the three-year filing requirement associated with PGA provisions is another reason. Of the remaining pipelines, many have agreed through rate settlements or certificate conditions to some periodic rate review, generally in 2 or 3 year intervals. Finally, when federal tax rates were reduced. As a result of the 1986 Tax Reform Act, most pipelines were required by previously approved settlement agreements to reduce their rates to reflect the decrease in tax rates.

In contrast, electric utilities have not been in a construction mode and thus have not been faced with increasing costs in the more recent past. Thus, changes in the tax rate as a result of the 1986 Tax Reform Act and declining cost of capital from the higher rates experienced in the early 1980's resulted in lower costs to the electric industry. This led the Commission to announce a voluntary rate filing procedure that allowed electric utilities to file lower rates reflecting the tax rate decreases as shown on Attachment 3. And, where the electric utility did not make a voluntary filing, the Commission instituted a section 206 proceeding.

Question 6. Trends in Natural Gas Prices and Pipeline Rates: What has been the general history of natural gas burnertip prices, wellhead prices and pipeline rates since 1980?

Answer. Average national yearly prices since 1980 for wellhead, city gate, burnertip (average to all customers), and residential are shown in attachments 4 and 5. (Please note that city gate prices were not available before 1984 and therefore are not reflected in these attachments).

Of most importance to the Commission is the results since the advent of open access—roughly represented by the results since 1984. Particularly important are changes in the price levels and margins at the various levels in the delivery of natural gas.

When measured in absolute dollars, from 1984 to 1990 wellhead prices declined 35 percent, city gate prices declined 23 percent, burnertip prices declined 13 percent, and residential prices declined 5 percent. When inflation over the period is taken into account (prices converted to real prices using the Consumer Price Index) the decreases are larger: 47 percent for wellhead, 37 percent for city gate, 29 percent for burnertip, and 23 percent for residential.

While the wellhead prices have fallen 94 cents or 35 percent since 1984, the margin for pipeline transportation has increased by 2 cents or 1.6 percent. However, the LDC margin for distribution has increased to all customers by 27 cents or 30 percent and to residential customers by 57 cents or 26 percent. The changes in margins are most vividly revealed in attachment 6.

These results clearly indicate that Congressional legislation such as wellhead deregulation plus Commission initiatives such as open access have benefited consumers. Lower wellhead prices were almost fully reflected in lower city gate prices, since transportation margins increased only slightly. However, burnertip prices, and especially residential prices, did not fully reflect the fall in city gate prices because distribution margins rose. The Commission has no jurisdiction over distribution margins; nor can I explain why these margins have risen so sharply. The state Commissions are in a better position to explain these occurrence.

As shown on the Electrical Rate Chart (Attachment 7), the same cannot be said of electricity users. From 1984 to 1989, the price to residential customers has risen 46 cents or 6 percent and the price to all electricity users has risen 19 cents or 3 percent.

Question 7. Time Limits on Refund Exposure: S. 933 does not place time limits on the period for which a pipeline may be required to make refunds as a result of an NGA section 5 proceeding. In contrast, the Regulatory Fairness Act specified time limits for the duration of an FPA section 206 complaint proceeding and the period for which an electric utility may be liable for refunds. Would S. 933 create greater risk for pipelines than that now imposed on electric utilities?

Answer. Yes, it appears that pipelines would have greater risks than electric utilities. S. 933 does not place time limits on the period for which a pipeline may be required to make refunds as a result of an NGA section 5 proceeding. As a result, the pipeline would be liable for refunds until the proceeding is terminated. In general, the longer the delay in resolving the case and making refunds, the greater the degree of uncertainty, which has an effect on risk. By contrast, the Regulatory Fairness Act places a time limit of fifteen months on the electric utility's refund exposure. This time limit can only be extended if the Commission finds that the utility has been responsible for delaying the proceeding.

Question 8. Refund Liability and Burden of Proof: S. 933 proposes to amend NGA section 4 to authorize refunds in cases where pipelines file to reduce or restate their rates and shifts the burden of proof with respect to such filings.

(a) Was the parallel provision of the FPA, section 205, amended in this way in the Regulatory Fairness Act?

(b) How might such an amendment of NGA section 4 affect the "substantial similarity doctrine" of case law precedent cited by the courts when construing NGA section 4 and FPA section 205?

Answer. The Regulatory Fairness Act did not amend the parallel provision of the FPA, section 205. The Regulatory Fairness Act amended section 206 of the FPA, which is the parallel provision to section 5 of the NGA and deals with complaint proceedings.

Since NGA section 4 and FPA section 205 no longer would be parallel with regard to refunds and burden of proof, cases under one statute might not be accepted by the courts as precedent for cases under the other statute. For example, the D.C. Circuit refused to construe a recent section 5 case based on FPA section 206 precedent since the adoption of the Regulatory Fairness Act. That court stated: "This amendment, [the Regulatory Fairness Act] designed to overcome the disincentive facing electric utilities to speed and settle Section 206 cases, introduces a significant difference in the regulatory approaches of the Natural Gas Act and the Power Act. Our discussion here, then must be understood to apply only to the Natural Gas Act." *East Tennessee Natural Gas Co.* v. *FERC,* 863 F.2d 932 (D.C. Cir. 1988).

Question 9. Natural Gas Pipeline Rates of Return:

(a) What is the average earned rate of return for natural gas pipelines today? How does this compare to the average allowed rate of return for pipelines?

(b) How do pipelines' current average earned rates of return compare to that in 1985?

(c) How do pipelines' average earned rates of return compare to those of local distribution companies, combined electric and gas utilities, and investor-owned electric utilities?

(d) What are the significant factors that affect natural gas pipelines' earned rates of return?

(e) In your opinion, are current natural gas pipeline earned rates of return sufficient to ensure the financial health of the natural gas pipeline industry?

Answer 9(a). Based on data from the 1990 FERC Form No. 2 annual reports of jurisdictional gas pipelines to the FERC, 40 major natural gas pipelines regulated by the Commission earned, on average, a return of 13.7 percent on their average common equity in 1990. Returns allowed gas pipelines on their average common equity in settlement negotiations averaged 12.63 percent in 1990 on an average ratio of common equity to total capital of 53.27 percent. For the first six months of 1991, equity returns allowed gas pipelines in settlements averaged 13.37 percent on an average common equity ratio of 47.71 percent.

Answer 9(b). Based on FERC Form No. 2 data, the major jurisdictional pipelines earned an average return of 13.7 percent on common equity in 1990. This is compared to a 12.6 percent average common equity return earned by these companies in 1985.

Answer 9(c). The 13.7 percent common equity return earned by major FERC-regulated natural gas pipelines in 1990 compared as follows with equity returns earned by other types of utilities:

Utility type	No. of companies	Earned equity return (percent)
Natural Gas Transmission Companies	5	10.2
Local Distribution Companies	53	10.7
Combined Electric & Gas Utilities	47	12.0
Investor-owned Electric Utilities	61	12.2

Source: C.A. Turner Utility Reports, May, 1991.

The C.A. Turner Utility Report shows the average equity returns for five diversified energy corporations that are primarily transmission companies: Coastal Corporation, ENRON Corporation, Panhandle Eastern Corporation, SONAT, Inc. and Transco Energy Corporation. Because this report reflects a smaller sample, as well as the non-pipeline business of these corporations, the average equity return differs from the previously cited FERC Form No. 2 average equity return for 40 interstate pipelines.

Answer 9(d). The primary factors affecting the rates of return earned by natural gas pipelines are business and financial in nature. Business-related factors include the rate of growth in demand for energy within a pipeline's market area, the degree of both gas-to-gas and inter-fuel competition within the market area, a pipeline's cost to provide service, and the pipeline's mix of business between firm and interruptible customers. The principal financial factor affecting a pipeline's rate of return is the degree of financial leverage, or the proportion of debt in the pipeline's capital structure.

Answer 9(e). Generally, current natural gas pipeline earned rates of return are sufficient to ensure the financial health of the natural gas pipeline industry. The 13.7 percent average equity return earned in 1990 by the major gas pipelines jurisdictional to the FERC was the highest average equity return earned by the group since 1984. It should be noted that, as with any average, some pipelines earned returns that were above the group average while others, for various reasons, earned returns that were below the average.

Question 10. Who is the Ratepayer That Benefits: Is it not true that in many cases the shipper of natural gas on an interstate pipeline is not an LDC or ultimate consumer of the gas, but rather a broker or marketer of natural gas? Should S. 933 become law, would such marketers or brokers be under any obligation to flow through any refunds that it might receive from a pipeline?

Answer. In certain cases, brokers, marketers and producers are the shippers of natural gas on pipelines rather than LDC's or ultimate consumers. Should S. 933 become law, such marketers, brokers, or producers would be under no statutory or regulatory obligation to flow refunds through to their customers, just as they are under no obligation to do so under the present laws and rules.

Question 11. Pipeline Rate Discounting: Under FERC's regulations, interstate pipelines may discount their rates for open access transportation service. How frequently do pipelines in fact discount their rates for transportation service and what is the magnitude of such discounts?

Answer. The Commission's open access programs have fostered competition among interstate pipelines and as a result most, if not all, interstate pipelines currently provide discounts on certain transportation volumes flowing through their systems. Pipelines approach discount requests on a case-by-case basis and offer discounts to meet competition and to flow volumes that otherwise would not flow absent a discount. The magnitude of discounts offered varies from pipeline to pipeline, and month to month, due to competition. The Commission examines the magnitude and the frequency of discounts on the pipeline's system in individual rate cases.

[Attachment 1]

COLUMBIA GAS TRANSMISSION CORPORATION, AND COLUMBIA GULF TRANSMISSION COMPANY PROCEDURAL SCHEDULE

DOCKET NOS. RP90-108-000, AND RP90-107-000

Columbia Gas Transmission Corporation and Columbia Gulf Transmission Company filed general Section 4 rate increase filings in Docket No. RP90-108-000, and RP90-107-000, respectively, on April 31, 1990. The Commission accepted and consolidated the filings by order issued May 31, 1990. Such order consolidated the proposed rate increase filings into one proceeding, and set them for hearing. Additionally, the order required Staff to serve top sheets on or before August 31, 1990, and that a prehearing conference be convened to establish a procedural schedule for the consolidated proceeding.

At the September 17, 1990 prehearing conference the Administrative Law Judge (ALJ) established the procedural schedule in this case. On February 1, 1991, Columbia Gas filed, in Docket No. RP91-82-000, pursuant to Section 4 to implement a new Firm Off-Peak Transportation service (OPT) to be provided under its open-access certificate for self-implementing transportation services. On March 1, 1991, the Commission accepted Columbia Gas' OPT filing and ordered that such docket be consolidated with the ongoing rate proceedings in RP90-108 et al. Furthermore, the Commission directed that the procedural schedule in that docket be modified to accommodate the resolution of all issues raised by the OPT filing. At a prehearing conference on March 20, 1991 the ALJ, ordered that all dates in the originally established procedural schedule be moved forward by 5 months. The hearing established in this proceeding is currently scheduled to begin Tuesday January 28, 1992.

PROCEDURAL SCHEDULE

November 2, 1990—Data Requests to Company
November 8, 1990—Objections to Data Requests

November 15, 1990—Motions to compel compliance with data requests
January 4, 1991—Responses to Data requests
February 15, 1991—Filing of Staff/Intervenor direct and answering testimony
March 1, 1991—Data requests to Staff/Intervenors
March 8, 1991—Objections to data requests
March 15, 1991—Motions to compel compliance with data requests
April 26, 1991—Responses to data requests
June 7, 1991—Filing of Columbia Companies' rebuttal and cross-answering testimony from Staff/Intervenors testimony
June 21, 1991—Data requests to 6/7 testimony
July 23, 1991—Responses to data requests
August 23, 1991—Filing of Staff/Intervenor rebuttal testimony on issues for which they bear burden of proof
September 24, 1991—Hearing commences

REVISED PROCEDURAL SCHEDULE—MARCH 20, 1991

Supplemental Direct Testimony filed by Columbia on OPT—Tues., June 4, 1991
Data Requests on Supplemental Testimony and issues to OPT—Fri., June 14, 1991
Objections to Data Requests—Fri., June 21, 1991
Motions to Compel Compliance With Data Requests—Fri., June 28, 1991
Responses to June 14 Data Requests—Tues., July 23, 1991
Staff and Intervenor Testimony (Direct and Answering)—Tues., August 27, 1991
Data Requests to Staff & Intervenors—Tues., September 10, 1991
Objections to Data Requests—Tues., September 17, 1991
Motions to Compel Compliance With Data Requests—Tues., September 24, 1991
Responses to Sept. 10 Data Requests—Tues., October 8, 1991
Columbia and Columbia Gulf Rebuttal and Answering Testimony and Staff and Intervenor Cross-Answering Testimony-Fri., November 8, 1991
Data Requests Directed to Testimony filed on November 8, 1991—Tues., November 19, 1991
Responses to November 19 Data Requests—Mon., December 16, 1991
Staff and Intervenor Rebuttal Testimony Covering Issues on Which They Bear the Burden of Proof—Fri., January 17, 1992
Hearing 10:00 a.m.—Tues., January 28, 1992

[Attachment 2]

SOUTHERN NATURAL GAS COMPANY PROCEDURAL SCHEDULE

DOCKET NOS. RP89-224 ET. AL.

Southern Natural Gas Company filed a Section 4 rate increase filing in Docket No. RP9O-139-000 on June 29, 1990. The Commission accepted the filing by order issued July 27, 1990. Such order consolidated the proposed rate increase filing with Southern's ongoing rate proceeding in Docket No. RP89-224, set the filing for hearing and required Staff to serve top sheets on or before November 1, 1990.

On February 13, 1991, the Administrative Law Judge issued an order establishing a procedural schedule in those proceedings. Such schedule provides for a public hearing to commence on November 5, 1991.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Southern Natural Gas Company) Dockets Nos. RP89-224-000
) RP89-203-000
) RP90-139-000
) and RP91-69-000

ORDERS ESTABLISHING PROCEDURAL SCHEDULE

(Issued February 13, 1991)

A prehearing conference was held in these proceedings February 12, 1991, after which counsel for the Commission's Staff ("Staff") delivered to me a proposed schedule to which all present participants had either agreed or withheld opposition.

It is, therefore, **ordered:**

1. Unless otherwise ordered in writing, future procedures in these proceedings will be governed by the following schedule (all dates are 1991, and all except the hearing date are "on or before"):

March 1 : Any participant may serve discovery requests on Southern Natural Gas Company ("SNG"), addressed only to the testimony filed by SNG January 3 and February 12.

March 8 : SNG may object to discovery requests served on it.

March 14 : Oral argument on objections to discovery requests will be held at 10:00 a.m. in a hearing room of this Commission at 810 First Street, NE, Washington, D. C.

March 21 : Deadline for answering discovery requests objections to which have not been sustained.

April 4 : Intervenors and Staff may file and serve (1) their direct testimony and (2) their testimony answering SNG's direct testimony.

April 18 : Any participant may serve discovery requests on any other participant, addressed only to the testimony authorized to be filed April 4.

April 25 : Any participant served with discovery requests may object to them.

May 2 : Oral argument on objections to discovery requests will be held at 10:00 a.m. in a hearing room of this Commission at 810 First Street, NE, Washington, D. C.

May 16 : Deadline for answering discovery requests objections to which have not been sustained.

May 21 : Participants shall file a joint statement of issues. It must include statements, by participants that filed (or will file) testimony, of issues on which any participant asserts that a participant other than SNG has the burden of proof.

June 10 : Intervenors and Staff may file and serve their testimony cross-answering each others' testimony.

June 17 : Any participant may serve discovery requests on any other participant, addressed only to the testimony authorized to be filed June 10.

June 24 : Any participant served with discovery requests may object to them.

July 2 : Oral argument on objections to discovery requests will be held at 10:00 a.m. in a hearing room of this Commission at 810 First Street, NE, Washington, D. C.

July 16 : Deadline for answering discovery requests objections to which have not been sustained.

August 6 : SNG may file and service its rebuttal testimony.

August 27 : Intervenors and Staff may serve discovery requests, addressed only to SNG's rebuttal testimony.

August 28 : Intervenors and Staff must give notice of issues on which they intend to file surrebuttal testimony.

September 4 : Any participant served with discovery requests may object to them.

September 11 : Oral argument on objections to discovery requests will be held at 10:00 a.m. in a hearing room of this Commission at 810 First Street, NE, Washington, D. C.

September 25 : Deadline for answering discovery requests objections to which have not been sustained.

October 16 : Intervenors and Staff may file and serve surrebuttal testimony on issues in which it is asserted that they have the burden of proof.

October 23 : Any participant may file and serve motions to strike any testimony previously filed.

November 5 : A public hearing in these proceedings will commence at 10:00 a.m. in a hearing room of this Commission at 810 First Street, NE, Washington, D. C.

2. Any pleading or other document required to be filed with this Commission will be deemed timely filed and served only upon compliance with the general requirements of Rules 2001 and 2010, and with the specific requirements set out in these ordering paragraphs, on or before the dates specified in this schedule.

3. Participants must comply with the requirements of Rules 2001-05 and 2010, and must deliver to me true copies of all pleadings filed with this Commission in these proceedings. N.B.: All copies delivered to me must bear the filing stamp of this Commission's Secretary, in default of which they will be neither retained nor considered by me.

4. Written testimony proposed to be offered as an exhibit (as distinguished from pleadings) filed under this schedule is not to be filed with the Secretary of this Commission. It is, rather, to be filed in Room 921, at 810 First Street, NE, Washington, DC 20426. Only a single copy of such testimony, for my use, is to be filed there. Copies must be served on all participants as required by Rule 2010. The requirements of Rule 508 must be satisfied, however, before an exhibit will be received in evidence at the hearing.

5. Discovery requests and responses to discovery requests must satisfy the requirements of Rule 406.

6. Responses to discovery requests, other than objections, must also satisfy the general requirements of Rules 403(c) plus the following specific requirements:

a) Each set of responses must contain a list of all persons who supplied data, calculations, interpretations, opinions, or any other materials used in the preparation of that set of responses. Each list must contain the name, title, connection with the responding participant, business mailing address, business telephone number, and business facsimile or telecopier (FAX) number of each person listed.

b) Each individual response to an individual discovery request must identify each person contributing to that response by a last-name or similar brief designation.

c) Each set of responses must be signed by the officer, employee, agent, expert witness, consultant, or other representative of the responding participant who must assume and bear the ultimate responsibility for the truth of all responses in the set. If that responsibility is to be shared, the signatures of all responsible persons must be appended, with notations designating the responses for which each signer is responsible. If the title, connection with the responding participant, business mailing address, business telephone number, and business facsimile or telecopier (FAX) number of a signer do not appear elsewhere in the set of responses, they must be shown below the signature and printed name of that signer.

7. Objections to discovery requests must satisfy the requirements of Rule 410 and be made in the form of written formal pleadings addressed to me, with copies served on counsel for the participants making the requests. Objections must contain full statements of the grounds urged in their support and they must contain or be accompanied by copies of the discovery requests to which they are addressed, in default of which they will be summarily overruled. Correspondence or other papers between counsel, or from counsel to the undersigned, will not be deemed or treated as objections. The filing of objections will not, by itself, stay any scheduled procedural step.

8. Service on counsel for participants of any pleading or other document must be accomplished as follows on or before the date the pleading or document is due to be filed:

a) On Washington, D. C., counsel: By hand delivery or by facsimile or telecopier (FAX).

b) On counsel outside Washington, D. C.: By overnight express delivery (Federal Express or its equivalent) or by facsimile or telecopier (FAX).

Joseph R. Nacy

Joseph R. Nacy
Administrative Law Judge

Attachment 3

FEDERAL ENERGY REGULATORY COMMISSION

WASHINGTON, D.C. 20426

NEWS RELEASE

NEWS MEDIA CONTACT:
Barbara Connors
202/357-8380

FOR IMMEDIATE RELEASE
June 26, 1987
Docket No. RM87-4

FORMULA FILING FOR LOWER ELECTRIC RATES ADOPTED; CHANGES REFLECT 1986 TAX REFORM ACT

The Federal Energy Regulatory Commission today adopted a voluntary rate filing procedure that would allow electric utilities to file lower rates to reflect a 12 percentage point income tax rate decrease. The final rule is effective immediately.

The Tax Reform Act of 1986 calls for a reduction in the Federal corporate income tax rate from 46 percent to 34 percent, beginning July 1, 1987.

Concerned that large overcollections on an industry-wide basis may occur unless rates are reduced promptly, the Commission's final rule uses a generic approach to the rate filing procedure. "Through a generic reduction in rates based on a formula," the Commission said, "a utility would be able to adjust for changes in the corporate tax rate by using an expedited procedure that would provide consumers immediate rate relief."

The rate reductions will be based on a formula using data provided by the utility in its most recent rate filing. Since a utility's rates generally differ for each customer group and on the service provided, the utility must make a separate rate reduction calculation for each type of service and each customer group. Rates that may be reduced using this formula are full or partial requirement rates and firm wheeling rates.

If a utility does not voluntarily reduce its rates, either through the abbreviated filing or a general rate change, the Commission intends to undertake a general review of the utility's rates and institute a formal rate investigation if it believes the utility is overcollecting as a result of the tax rate reduction.

Although the final rule extends the time during which utilities may make the abbreviated filing, the Commission emphasized that new rates will be effective July 1, 1987, regardless of when the application is filed. The Commission is waiving any notice requirements in order to make July 1 the effective date of the new lower rate.

(MORE)

A utility using the abbreviated filing procedure must refund to its customers the difference between the unadjusted rate for the tax change and the new rate reflecting the tax adjustment. In order to encourage utilities to use the procedure, there will be no requirement that refunds be made with interest.

In addition to the waiver of the interest requirement, the Commission is also waiving filing fees to encourage use of the voluntary procedure.

In order to process the revised rate filings more expeditiously, the Commission is establishing the following filing schedule for utilities to follow:

If the First Letter of Utility Name Begins With	The Filing Period Deadline Is
A through B	September 15, 1987
C through E	September 30, 1987
F through L	October 15, 1987
M through N	October 31, 1987
O through S	November 15, 1987
T through Z	November 30, 1987

(30)

Average National Natural Gas Prices
(Dollars per Thousand Cubic Feet)

Price	1980	1981	1982	1893	1984	1985	1986	1987	1988	1989	1990	Change 1984-1990
Wellhead	$1.59	$1.98	$2.46	$2.59	$2.66	$2.51	$1.94	$1.67	$1.69	$1.69	$1.72	($0.94)
City Gate	N/A	N/A	N/A	N/A	$3.95	$3.75	$3.22	$2.87	$2.92	$3.01	$3.03	($0.92)
Burnertip	$2.91	$3.51	$4.32	$4.82	$4.85	$4.72	$4.13	$4.05	$4.09	$4.22	$4.20	($0.65)
Residential	$3.68	$4.29	$5.17	$6.06	$6.12	$6.12	$5.83	$5.54	$5.47	$5.64	$5.77	($0.35)

Source: EIA/Natural Gas Annual 1988 Volume 1
Source: EIA/Natural Gas Monthly (May 1991; DOE/EAI-0130(91/05)
Source: EIA/Monthly Energy Review (April 1991)

Attachment 4

Attachment 5

Average National Natural Gas Prices 1/
(Dollars per Thousand Cubic Feet)

Price	1984	1985	1986	1987	1988	1989	1990	Change Since 1984	Change Since 1985
Wellhead	$2.66	$2.51	$1.94	$1.67	$1.69	$1.69	$1.72	($0.94)	($0.79)
City Gate	$3.95	$3.75	$3.22	$2.87	$2.92	$3.01	$3.03	($0.92)	($0.72)
Burnertip	$4.85	$4.72	$4.13	$4.05	$4.09	$4.22	$4.20	($0.65)	($0.52)
Margins									
Transportation	$1.29	$1.24	$1.28	$1.20	$1.23	$1.32	$1.31	$0.02	$0.07
Distribution	$0.90	$0.97	$0.91	$1.18	$1.17	$1.21	$1.17	$0.27	$0.20
Percent Change		From Previous Year						Cummulative	
Wellhead		-5.64%	-22.71%	-13.92%	1.20%	0.00%	1.78%	-35.34%	-31.47%
Transportation		-3.88%	3.23%	-6.25%	2.50%	7.32%	-0.76%	1.55%	5.65%
Distribution		7.78%	-6.19%	29.67%	-0.85%	3.42%	-3.31%	30.00%	20.62%
Percent of Delivered Price									
Gas Price	55%	53%	47%	41%	41%	40%	41%	-14%	-12%
Transportation Margin	27%	26%	31%	30%	30%	31%	31%	5%	5%
Distribution Margin	19%	21%	22%	29%	29%	29%	28%	9%	7%
	100%	100%	100%	100%	100%	100%	100%		

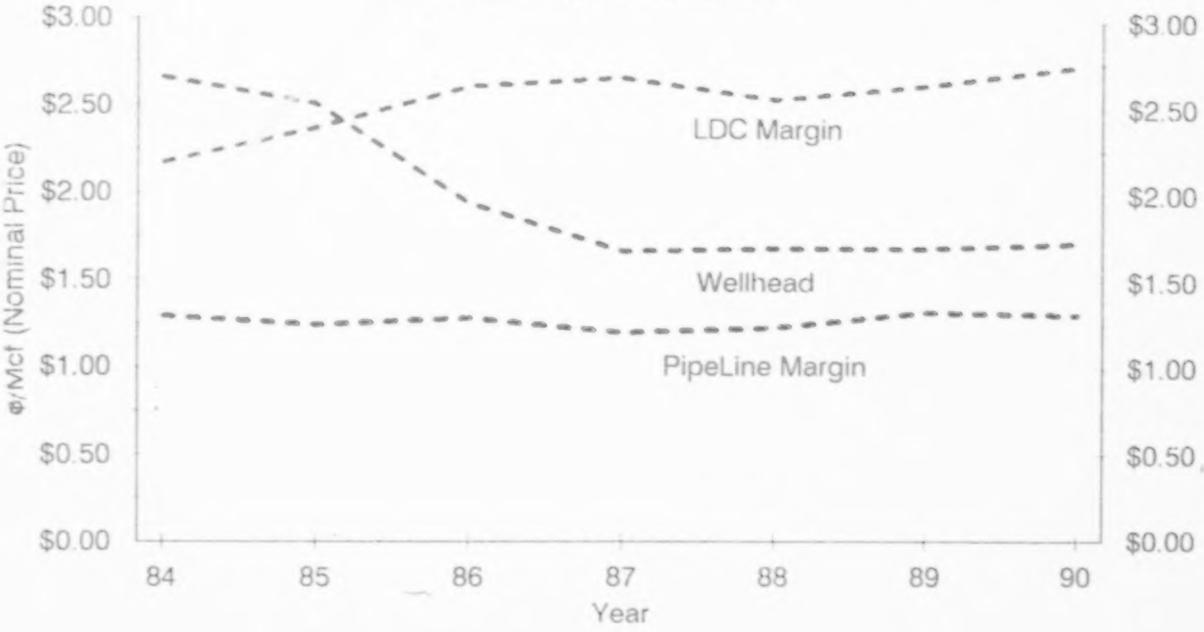
1/ Source: EIA/Natural Gas Monthly (May 1991; DOE/EIA-0130(91/05); and (May 1990; DOE/EIA-0130(90/05). From: "Table 4. Selected National Average Natural Gas Prices".

July 18, 1991 Edition; wem/OPPR

Attachment 6

3: Natural Gas Price Margins for Residential Customers

Yearly Averages, 1984 to 1990



Source: Energy Information Administration, Monthly Energy Review, Table 9.11, April 1991

Average Electric Utility Prices
(Cents per Kilowatt Hour)

Price	1980	1981	1982	1893	1984	1985	1986	1987	1988	1989	Change 1980-1989
Residential	5.12	5.86	6.44	6.83	7.17	7.39	7.43	7.45	7.49	7.63	2.51
Industrial	3.44	4.03	4.66	4.68	4.88	5.04	4.99	4.82	4.71	4.79	1.35
Total Ultimate Customers	4.49	5.16	5.79	6.00	6.27	6.47	6.47	6.39	6.36	6.46	1.97
Annual Percent Change											
Residential		14.45%	9.90%	6.06%	4.98%	3.07%	0.54%	0.27%	0.54%	1.87%	
Industrial		17.15%	15.63%	0.43%	4.27%	3.28%	-0.99%	-3.41%	-2.28%	1.70%	
Total Ultimate Customers		14.92%	12.21%	3.63%	4.50%	3.19%	0.00%	-1.24%	-0.47%	1.57%	

Source: EEI/Statistical Yearbook of the Electric Utility Institute 1989

QUESTIONS FOR JOHN E. OLSON OF GOLDMAN, SACHS & CO.

Question 1. Financial Challenges for Pipelines: From Wall Street's perspective, what are some of the financial challenges facing the interstate pipeline segment of the natural gas industry?

Answer. The pipeline industry is faced with major financial challenges in the 1991-1994 period as it confronts three adversities; (a) ballooning capital spending needs; (b) deteriorating balance sheet liquidity and falling credit ratings; and (c) an increasingly unreceptive equity capital market. Wall Street perceptions are visibly more stressed by recent events in both debt and equity markets. Some of those have included; (1) pipelines spending trends more than doubling during the 1991-1994 period: from $1.5 billion annually to $3.5 billion. (2) Rising, rather than falling debt leverage ratios; the public books of pipelines show 60% balance sheet leverage and about $330 mm of deficit working capital. This has resulted in a progressive erosion in debt ratings, which in our calculation fell 23% in the 1984-1991 period. (3) Equity investors—the true risk takers in a democracy—have been shunning pipeline equities. Indeed, since "Black Monday" in October, 1987, pipeline issues have advanced 22% while the market is up 71%. This underperformance has become dramatically visible since the last stock market bottom of October 11, 1990. Whereas the market (S&P 500) has risen 30% in the past nine months, gas stocks have declined by 12%! This is a stunning market vote of no confidence. Recently, one pipeline (Panhandle Eastern) had to sell common stock at a 15% discount to its book value; while another (Columbia Gas) had to threaten bankruptcy with its producers. Investors should have little wonder why pipeline securities have become Wall Street pariahs.

Question 2. Effect of Regulatory Policy: To what extent does regulatory policy affect Wall Street's assessment of the financial viability of the interstate pipeline segment of the natural gas industry? What is your assessment of the current regulatory environment for interstate pipelines? Please give examples of specific regulatory policies and how they affect your assessment of the financial viability of interstate pipelines.

Answer. Wall Street has become increasingly disappointed in and alienated from FERC policymaking. FERC staff had largely ignored investment risk/return considerations during the 1984-1991 partial deregulation era. Simply put: policymakers expected investors to remain a hypothetical "given" while they vastly increased risks and diminished returns involved with open-access transportation. Investors have simply downgraded the industry through inevitable credit rating cuts; not to mention shedding large amounts of shares in their portfolios. Unless the current regulatory environment changes direction and tone, we anticipate further deterioration in investor confidence. Specifically, (a) timely rate cases with realistic returns on equity are of the highest priority. Wall Street investors and observers quickly see through the ROE determination charades ritualized by FERC staff; no one believes them, and accordingly staff credibility remains at subterranean levels. (b) Modified Fixed Variables (MFV) rate design has been a blessing to very few pipelines and a curse to the majority. Discounting might have been a modest boon to consumers; but the attendant halving of pipeline returns on equity has meant more leveraged balance sheets and higher interest expense, along with marginal credit ratings. Utility investors expect utility returns. They have not received them since 1984. In sum, we think the regulatory and ratemaking policies under the Natural Gas Act have become encrusted with over fifty years of bureaucracy. They have outlived their usefulness. They have become the problem. They need to change. It is time for a new Natural Gas Act.

Question 3. Relative Performance of Natural Gas Industry Segments: Since 1984, what segment of the natural gas industry has had the best financial performance? What were some of the reasons for this? Why didn't other segments of the industry perform as well?

Answer. During 1984, the FERC eliminated most of the industry's minimum bills, thereby starting a long decline in returns on equity that is still underway. Between 1985 and 1990, the pipeline industry earned a meager 7%-8% while ostensibly being allowed about 13%. Local distribution companies earned a steady 13%-15%, and clearly had a better success on Wall Street. Exploration and production companies have been earning a token 2½%-5% on equity; and have been a losing proposition investmentwise.

Question 4. Effect of S. 933: If S. 933 were to become law, how might this affect Wall Street's assessment of the natural gas industry?

Answer. Amending the NGA provisions would upset 50 years of regulatory conventions and case law. Washed away in the process would be stock and bondholders? Confidence in the certainty of rates: S. 933 appears to be a belated reaction to the protracted and highly complicated settlement rate cases of the 1987-1989 period. These have been completed. Closing the proverbial barn door after the horse is gone would have the side impact of damaging rate certainty. We strongly feel this game is not worth the prize.

SONAT INC.
Birmingham, AL, July 16, 1991.

Hon. TIMOTHY WIRTH,
Chairman, Subcommittee on Energy Regulation and Conservation, U.S. Senate, Dirksen Senate Office Building, Washington, DC.

DEAR SENATOR WIRTH: Thank you for allowing me to testify on behalf of the Interstate Natural Gas Association of America before your Subcommittee on S. 933, the Natural Gas Ratepayers Relief Act of 1991. Attached please find answers to the follow-up questions on two issues which were raised at the hearing.

Senator Metzenbaum implied that take-or-pay settlement costs suffered by the pipeline industry were a result of the pipelines' own bad business judgment. I take issue with this characterization. Pipelines were trying to end a decade of regulatory induced shortages and "take-or-pay" clauses were industry norms, in virtually 100 percent of the contracts. Entering into take-or-pay contracts was, therefore, sound and prudent, especially given the fact that the take-or-pay contracts were "mirrored" in pipeline sales contracts through "minimum bills".

It was the regulatory impact of eliminations of the minimum bills without offsetting this action by invalidating the take-or-pay contracts that caused the take-or-pay problem, not pipeline imprudence. The industry has been working to complete the transition envisioned for it by the regulators and I think it is fair to say that all along we have cautioned regulators and legislators as to the danger of the particular deregulatory approach which was taken. It is grossly unfair to the pipeline industry to imply that the costs of this transition are due to poor business judgment on the part of the pipelines.

Second, the transition of pipelines to open access transportation has not only increased the number of interested parties in pipeline rate cases (to include marketers, producers, brokers, etc.) causing more protracted litigation and settlement proceedings, but in many cases it might shift the payout of refunds to these parties. It is no longer clear that refunds will flow to a pipeline's LDC and direct industrial customers. Many of the refund dollars may now flow to these other parties without any obligation for them to be passed on.

Again, I appreciate the opportunity to have appeared before your Subcommittee and hope my testimony will be of value to its members. Please do not hesitate to contact me or INGAA if you have additional questions.

Your very truly,

RONALD L. KUEHN, JR.,
Chairman, President and CEO.

[Enclosure.]

Question 1. Explain in greater detail the basis for your assertion that the statutory three-year rate restatement requirement proposed in S. 933 would discourage pipelines from improving their efficiency.

Answer. FERC has announced a goal of developing innovative rates which will allow pipelines to respond in a more timely fashion to market forces. FERC testified that the statutory requirement in S. 933 would limit its flexibility regarding these new rate procedures. I fully agree.

Currently pipelines with PGAs (purchased gas adjustment) are committed to file a rate case every three years. This is a program designed by FERC and not required by statute. The effect is the same, however; pipelines have little incentive to improve efficiencies because the efficiencies are immediately lost in the rate process. Further, the process is expensive in terms of direct legal costs and in terms of lost time of senior executives addressing endless rate issues in multiple settlement conferences instead of creating new business for the benefit of customers and shareholders. Innovative rates and competition, not mandatory rate cases, can be expected to encourage efficiency and reward both pipelines and their customers for such efficiency.

Question 2(a). How is the regulatory structure of the electric industry different from the regulatory structure of the natural gas industry; in particular, how is it different with respect to the regulation of interstate natural gas pipelines under the NGA and the regulation of electric utilities under the FPA?

Answer. The most dramatic difference in regulatory structure is that states regulate the vast majority of electric power companies' business and FERC regulates only a very small percentage of power company revenues. FERC, on the other hand, regulates virtually 100% of a natural gas pipeline's business.

I also understand that the typical rate under which electric power companies carry out interstate transactions is a formula rate which exposes the power company to little or no risk.

Natural gas pipelines today face greatly increased competitive risks and FERC is in the middle of the process of adjusting pipeline rate structures and ROE's to recognize this risk. This needs to be sorted out at FERC. FERC has promised to do so and S. 933 will inhibit that program. There are no similar risks arising out of FERC's regulation of power companies because most power company businesses arise in state granted monopoly, franchise areas.

Question 2(b). Have electric utilities been subject to the same pro-competitive regulation as interstate natural gas pipelines have been?

Answer. Absolutely not. As stated, the electric utility industry remains for the most part a natural monopoly which operates in state granted franchise areas within which little or no competition is experienced for most of their business. The power industry has not experienced restructuring through open access which has led to the fierce competition currently occurring in the natural gas industry. While PURPA has the potential to introduce competition through small scale non-utility sources of generation, no significant competition (at least in our service area, the southeast) has developed to date.

Question 2(c). Is federal regulation as important for the electric utility industry as it is for the natural gas industry?

Answer. As stated above, federal regulation does not dictate how the vast majority of their transactions occur. The bulk of electric generation and sales is regulated at the state level. Consequently, the greatest rate impact for electric utilities occurs at the state level. In contrast, interstate natural gas pipelines are regulated solely at the federal level by the FERC. All of our rates are derived from transactions in interstate commerce.

Question 2(d). Are the electric utilities and natural gas industries similar in the way that they are structured? Are there differences in the markets that they serve?

Answer. The electric industry is vertically integrated and has no alternate fuel competition for large parts of their market. The natural gas industry is fragmented and has significant alternate fuel competition from fuel oil, propane, coal, wood and electricity. Indeed, one segment of the industry, production competes directly with the other segments through fuel oil sales.

The interstate natural gas pipeline industry has further suffered through restructuring by the FERC. We have gone from an industry of private contractors that purchased gas from producers and sold mainly to local distribution companies to one that primarily transports gas (80% of throughput) for others. As a result, many more parties are now involved. Producers, marketers, brokers, local distribution companies, industrials and other parties now seek with regularity to intervene in our rate cases. Prior to restructuring, it was primarily sales customers and consumer groups who intervened. As a result of the substantial increase in intervenors, it is much more difficult to settle these rate cases.

Question 2(e). In light of the foregoing, to what extent can it be argued that an amendment comparable to the Regulatory Fairness Act would be appropriate for the NGA?

Answer. The Regulatory Fairness Act is not appropriate for the NGA. As a result of passage of the NGPA and recent FERC action, the natural gas pipeline industry is continuing the transition to more competition brought about by restructuring and open access. As a result, pipelines are encountering more risk. As proof of this, many pipelines have experienced lower returns and their bond ratings have been lowered. FERC is continuing this transition with their "mega-NOPR" (Notice of Proposed Rulemaking). This NOPR will focus on comparability of service between traditional sales service and open access service, abandonment, pipeline service obligations, rate design reform, and treatment of gas purchase contract buyout and buydown costs. Attached is a survey of our membership on the potential costs that can be incurred as a result of this rulemaking. These costs are dependent on how much flexibility is provided for pipelines to work out the FERC proposals with their customers. The Regulatory Fairness Act is simply inconsistent with the course Congress dictated for the industry in 1978 with the NGPA and which FERC has been embarked on ever since.

Further, there is not a shred of proof of need. As stated above, unlike electric utilities, all of interstate pipeline rates are derived from transactions regulated by the

FERC. FERC and other parties, if they believe pipeline rates unjust, can petition for change under NGA Sec. 5 proceedings. Also, the consumer has prospered from the restructuring that has occurred to date by obtaining abundant supplies of cheap gas, open access transportation, and discounted pipeline rates. Pipeline earnings, on the other hand, have suffered.

Finally, pipeline management can deal effectively with either a highly regulated environment or competitive based regulation, but not both at the same time and not, without great expense, with the transition from one to the other. The transition costs have been enormous and the lack of certainty has inhibited long term, secure supply arguments. With the industry now firmly embarked on the transition from highly regulated to competitive based regulation and high transitions costs paid for, now is not the time to change directions. S. 933 appears to me to be just the sort of "midstream horse change" that signals another reversal in policy which the industry simply can't stand.

Question 3. How would statutory deadlines for FERC to issue a final order in rate proceeding affect FERC's administration of such proceedings, the rights of parties to such FERC proceedings and would you support deadlines?

Answer. As I stated at the hearing, I do not believe an artificial imposition of deadlines on FERC rate proceedings would be beneficial. A deadline would promote litigation because the FERC would issue decisions whether they were ready to do so or not. Deadlines would discourage settlements because of the complexity of the matters dealt with in settlements and the ever increasing number of participants. In short, artificial time limits could prevent the timely resolution of rate matters which are critical to a healthy natural gas pipeline industry in today's competitive environment.

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,
Washington, DC, July 26, 1991.

Hon. MARTIN L. ALLDAY,
Chairman, Federal Energy Regulatory Commission, Washington, DC.

DEAR CHAIRMAN ALLDAY: I would like to bring to your attention our latest analysis of the extent of contract carriage in the interstate natural gas market. The attached report, entitled "Carriage through 1990," shows that the level of carriage in 1990 has reached 79 percent of deliveries by interstate pipelines. Pipeline sales represented 21 percent of deliveries, down about a third from its 1989 level. The volume of pipeline sales in 1990 was 3.7 quads, a 26 percent decline from the 5 quads sold in 1989. Volumes delivered for customers using firm transportation service in 1990 exceeded pipeline sales for the first time, reaching 4.8 quads and representing 36 percent of the total carriage volume of 13.4 quads.

I believe that these high levels of carriage and firm transportation coupled with the decline in pipeline sales are clear indications that the pipeline industry is well on its way to comparability. Interstate pipelines are no longer a dominant provider of merchant services. Our customers are already using firm transportation as an effective means to access and secure various sources of alternate gas supply. Moreover, existing, filed and future settlement agreements negotiated with customers will further accelerate this trend.

With respect to the pipelines' merchant function, the Commission has stated on a number of occasions that it does not wish to force the pipeline industry out of that role. However, it is likely that some of the specific comparability conditions contemplated in the "mega-NOPR" (RM91-11, et al.) would inadvertently do just that. In particular, I am concerned that a number of rigid comparability conditions, such as complete unbundling of services, contract storage and production-era pooling points, might seem acceptable individually but taken as a whole could lead to reduced economies of scale for aggregation and transmission, higher costs to implement comparability and a merchant function that is economically and operationally infeasible for a number of pipelines. That would act to reduce rather than enhance the number of options available to city-gate customers today and possibly raise their overall costs of gas service.

We would support you in your efforts to implement comparability using a flexible approach that encourages pipelines to increase customer choices by offering both bundled and unbundles services at the city-gate, results in the lowest possible amount of implementation costs and assures complete recovery of such costs.

If I can be of any help to you in these efforts, please do not hesitate to call.

Sincerely,

JERALD V. HALVORSEN,
President.

INGAA

Report No. 91-3

July 1991

Rate and Policy Analysis Department

Issue Analysis

THE COSTS OF IMPLEMENTING COMPARABILITY

Executive Summary

Interstate natural gas pipelines urge the Commission to recognize its role in containing any transition costs which emerge as a result of movement toward comparability. INGAA supports the Commission's attempts to continue the development of open-access transportation through comparability, but feels that a smooth transition can only be accomplished with 1) a negotiating period to work out the necessarily different comparability characteristics on each pipeline, 2) a mechanism permitting pipelines to collect a fee for their merchant service, and 3) a mechanism allowing pipelines to recover all costs associated with implementing comparability. The Commission must acknowledge that flexibility is the key in fitting comparability to the individual shapes of different pipelines.

INGAA recommends that the Commission consider now, at the outset of the comparability proceeding, the potential costs associated with implementing comparability. It is within the Commission's control to make transition costs manageable through the method it selects to implement comparability. Many pipelines believe that if the Commission permits a flexible, negotiated approach, they can work with parties in their proceedings to hammer out a form of comparability which both satisfies the parties and minimizes transition costs to roughly $1 billion. On the other hand, pipelines attach a nearly $8 billion price tag to an inflexible approach to comparability which drives pipelines out of the merchant function.

It is not INGAA's intent to cite the potential for transition costs as a way to either slow down comparability unnecessarily or to show that comparability is unworkable. On the contrary, pipelines find the current regulatory climate untenable, and urge the Commission to implement comparability while simultaneously minimizing transition costs and providing pipelines the opportunity to manage such costs.

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
555 13TH STREET, N.W., #300 W • WASHINGTON, D.C. 20004 • 202/626-3200

PREFACE

INGAA Issue Analysis reports are intended to provide up-to-date information concerning topics of public interest and are for the purposes of study and discussion of legislation or regulations.

INTRODUCTION

In response to market needs and regulatory requirements, interstate natural gas pipelines are in various stages of offering services which will permit third parties to provide a merchant function comparable to the pipelines' sales service. This concept of comparability is the next phase of open-access transportation begun in 1985 with Order No. 436.

Because the requirements of comparability are generally more demanding than those of open-access transportation under Order No. 500, many pipelines will experience transition costs from the implementation of comparability. However, these transition costs do not have to be large. To a great extent, the Commission has control over the magnitude of these costs through the method it chooses to implement comparability. In order to provide the Commission the information it needs for reasoned decision-making as comparability is implemented, the interstate natural gas pipelines have undertaken - to estimate, even at this early stage before the Commission has defined comparable service, the costs associated with implementing comparability. The purpose of this report is to document the results of an INGAA survey of its members to determine the likely range of such transition costs.[1]

Pipelines learned from the transition costs known as take-or-pay that ignoring such costs until after they occur is bad public policy and only serves to delay completion of the transition.[2] For many reasons, pipelines cannot afford a delay in implementing comparability. Because of certain Commission orders—notably Order No. 380—

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[1] The survey was conducted in June 1991. Respondents were 20 interstate natural gas pipelines representing 76 percent of the market share as measured by total 1989 interstate natural gas deliveries (sales and transportation) as published by the Energy Information Administration (EIA), U.S. Department of Energy, *Statistics of Interstate Natural Gas Pipeline Companies 1989*, February 1991, Table 28.

[2] It is not INGAA's intent to detail here the cycle of Commission orders and court remands which plagued the implementation of open-access transportation in the 1980s. The Commission knows the difficulties inherent with finding a court-approved mechanism to deal with such costs once they have already occurred.

pipelines find the current regulatory rules unacceptable. The ability of firm sales customers to swing onto system supply without permitting pipelines an effective means to charge for that right frustrates the marketplace. Holding pipelines to their historic sales service obligations while their firm sales customers can choose to ignore—without adequate payment—the firm service agreement renders the pipelines' obligation to serve meaningless. While pipelines support the Commission in its effort to establish comparability to improve the current situation, they believe the Commission must simultaneously address the transition cost issue. Accordingly, pipeline support for comparability is linked inextricably to an approach which permits pipelines to both minimize and manage transition costs.

TWO COMPARABILITY SCENARIOS

To provide its members a framework within which to make transition cost estimates, INGAA developed two comparability scenarios.[3] The first scenario is a flexible rule that relies on negotiations; the second scenario assumes a rigid interpretation of comparability, including strict unbundling. A description of each scenario follows:

- *Negotiated Scenario: Flexible, Negotiated Terms.* This scenario assumes the Commission provides a flexible comparability program, reached primarily through negotiations between each pipeline and its customers and shippers, beyond what the pipeline had developed to meet the requirements of Order No. 500. All parties have an equal incentive to negotiate so that no one party has more bargaining leverage than others. Comparability is defined here as providing pipeline customers with meaningful choices at the city-gate, including but not limited to both bundled and unbundled services. Pipeline services would be restructured to offer a firm transportation service which is a reasonable substitute for the transportation service imbedded in the sales service. No time frame is imposed on the pipeline's implementation of terms and conditions of comparability, or restructuring of service to achieve comparability.

- *Strict Scenario: Inflexible, Generic Rule.* This scenario assumes a strict interpretation of the comparability principle outlined in the Staff Appendix

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[3] Because the Commission is just beginning to formulate what will be expected of pipelines under comparability, it is not possible to estimate a single number which represents the transition costs. The range of comments filed in response to the Commission's public conference on May 10, 1991, demonstrated a wide variance in both what comparability ought to achieve and how it should be implemented. Until the Commission issues a notice outlining in some detail its expectations for comparability, pipelines can only guess at the scope of the concept.

attached to the April 11, 1991, FERC Notice of Public Conference, or the approach advocated by many producers at the May 10 conference. In fact, this scenario was described to respondents as equivalent to the "Ten Commandments" presented by producers at the public conference. Comparability under this scenario mandates some form of pooling near receipt points, equal firm capacity rights at all receipt points and on mainline segments, equal rights to firm storage, and so on. The effect of such a definition is to allow shippers an ability *equal* to the pipelines to supply a merchant function. This generic comparability is described more completely in the Appendix.

WHY TRANSITION COSTS WILL OCCUR

Most, though not all, pipelines will experience transition costs as comparability is implemented. Aside from Commission action, whether a particular pipeline incurs such costs depends on a complex set of factors, including the evolutionary stage of open-access on that pipeline, its markets, its need for prior take-or-pay renegotiations, its success in those renegotiations, its physical configuration, and to some extent accidents of history, such as its relative proportion of old gas under the NGPA and the uneven effect Commission orders had on the pipelines.[4] Given the turbulent history of open-access transportation to date, it would be extremely unlikely for pipelines to find themselves equally positioned in their respective markets to implement comparability.

Some pipelines are positioned to implement comparability with few transition costs because their restructuring to date allows them to recover the cost of providing a merchant function, even under a relatively rigid form of comparability. But this situation does not describe most pipelines. Serious demands for comparability did not begin until long after Order No. 436, and the inevitability of comparable service did not become apparent until recently, after the completion of the contract reformations in the mid- to late-1980s as a result of Order No. 500. In Order No. 500 itself, there is no mention of requiring comparability before a gas inventory charge can be implemented. It is not surprising, therefore, that pipeline supply portfolios in general are not ready to address the more demanding requirements of comparability.

In short, contracts signed in the 1970s under a different regulatory environment, even those reformed for open-access rules, are in many cases not market-responsive enough to permit pipelines to compete with shippers who are unencumbered with supply contracts signed in another era. Even so, the transition costs on some pipelines can be manageable if the Commission ensures that comparability includes a mechanism for pipelines to charge a merchant fee, such as a gas inventory charge, which is large enough to recover costs resulting from the differential between the pipeline's average cost of gas and the spot price. That differential would reflect the cost of the pipeline's merchant function under its obligation to serve.

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[4] For instance, Order No. 451 affected some pipelines greatly and others little because of the mix of contracts signed in a previous era. On some pipelines, producers could raise the price of old gas under Order No. 451 and, because the pipeline had few or no high-cost contracts with that same producer, the average cost of gas increased for the pipeline. On other pipelines, the existence of high-cost gas contracts mitigated the effect of Order No. 451 to increase the pipelines' average cost of gas.

However, it may not be possible on all systems to fashion a merchant fee which is large enough to recover merchant-related costs, yet small enough to be competitive with producers, marketers, and others who under comparability are able to offer a merchant service comparable to the pipeline's. On these systems comparability could produce a need to restructure the merchant function, which means the pipeline must pay compensation, such as buydown or buyout payments, if pipeline sales are reduced below levels already reduced by open-access transportation under Order No. 500. Given the pipelines' various stages with respect to the take-or-pay problem, many now find themselves under pressure to reform contracts they just renegotiated for open-access, to reform contracts which did not need reformation under Order No. 500, or both. In the extreme, where a pipeline finds its current supply contracts are hopelessly uncompetitive under comparability, it might need to pay enough compensation to producers to completely rid itself of the merchant function.

Comparability is a two-way street. If pipelines are expected to change historical practices in order to enhance the ability of other shippers to compete with them, then equity requires that shippers must also change in any area in which they have a historical competitive advantage. Producers, many of whom are also shippers, continue to hold pipelines to long-term supply contracts signed prior to Order No. 436.[5] Indeed, many contracts contained indefinite price escalators, most-favored-nation clauses,[6] and other contract provisions which tied the price of gas to everything but the market. While appropriate for the regulatory scheme at the time,[7] these provisions and clauses are not market responsive in an era of comparability. Indeed, even historical fixed prices in old gas contracts may not be responsive to the level of competition expected under comparability. Many of these types of contract provisions were reformed under Order No. 500. However, pipelines retained their obligations to serve and had to balance carefully the incentive under Order No. 500 to reform contracts with the need to maintain service obligation levels. Consequently, each pipeline reformed only those prudently needing reformation under existing regulations at the time.

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[5] For instance, under comparability a producer could win a customer from a pipeline by offering a penny below the pipeline's cost of gas. The producer could then displace pipeline sales gas to that customer while still holding the pipeline to terms in the supply contract, such as minimum take provisions or even otherwise-reasonable take-or-pay provisions which had been reformed in the 1980s. The slight loss incurred by the producer would be more than offset by enforcing the terms of the supply contract with that pipeline.

[6] *Indefinite price escalators* are provisions which tie the price of gas to another commodity, the future price of which is unknown at the time the contract is signed. *Most-favored nation clauses* tie the price of gas to the average price derived from a set of highest-price contracts within a geographic region.

Finally, it is equitable and necessary for the Commission to make clear that the sales and transportation markets causing the transition costs, and those benefitting from comparability, will bear the burden of those costs, not the pipeline. Pipelines reject so-called the "equitable sharing" of prudently incurred transition costs associated with implementing comparability.

TYPES OF COMPARABILITY TRANSITION COSTS

For each scenario, respondents were asked to estimate their transition costs for reforming gas supply contracts, other supply-related costs, and the cost to add pipeline facilities which may be required to provide the kind of comparability suggested. They were also asked how the requirements of a flexible versus an inflexible approach would affect their facility needs.

Gas Supply

Respondents provided their estimates of the expected total costs resulting from the need to reform long-term contracts that pipelines signed to support their merchant function under a different regulatory scheme. Because a tenet of comparability is that a pipeline's firm transportation service should be a reasonable substitute for its sales service, the effect of comparability on the merchant function is of primary concern to many pipelines.

Respondents were also asked to provide information on the costs of reforming upstream contracts that support the merchant function, such as long-term contracts for firm transportation by other pipelines (Account No. 858), contracts for firm storage, gathering or supplemental supplies—such as liquefied natural gas (LNG) or synthetic

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[7] During the 1970s, when many of these long-term supply contracts were signed, wellhead prices were heavily controlled by federally mandated price ceilings. Because the market could not clear on price, the pipelines were forced to compete for gas on the basis of non-price terms, such as price escalator provisions, most-favored nation clauses, and take-or-pay provisions.

natural gas (SNG)—and unamortized prior period Account No. 191 costs that would not be recoverable if the PGA mechanism were eliminated along with the sales function under comparability. Respondents were asked to exclude costs that were incurred as a result of market conditions under Order No. 500; *e.g.*, past take-or-pay costs.

Pipeline Facilities

Many pipelines believe that some operations and facilities will be affected by any requirement that the pipeline offer comparable services to all customers. INGAA therefore asked pipelines to estimate costs under each scenario for:

- One-time costs to add facilities in order to make contract storage available to shippers on a comparable basis, or the cost to write off a storage facility no longer considered used and useful.
- Additional hardware, software, or administrative costs for further real-time gas tracking in order to provide firm shippers with up-do-date information on scheduling, imbalances, curtailments and system status.
- Any other one-time costs for facilities, systems, or services that would be required to implement comparability, such as expanding or upgrading mainline or receipt point facilities needed to provide shippers firm capacity rights that are comparable to the pipeline as merchant, or needed to provide flexibility in changing receipt points or gathering systems.

QUANTIFICATION OF TRANSITION COSTS DUE TO COMPARABILITY

Pipelines provided estimates of transition costs due to supply-related expenditures, and those due to adding equipment or other facilities to accommodate the market needs of comparability.

Supply-Related Transition Costs

The 20 pipelines responding to the survey indicated that they expect roughly $1.4 billion in supply-related costs under the negotiated scenario, in which each pipeline can tailor comparability to the needs of its customers and its system. Under the strict scenario, the respondents reported a total of $7.7 billion in supply-related costs. Each of these estimates is broken down in Table 1 below.

Table 1
Supply-Related Transition Costs for Comparability
(Millions of Dollars)

	Negotiated Scenario		Strict Scenario	
	($MM)	(%)	($MM)	(%)
Supply Contracts	1168	85	4748	62
Upstream Transportation (Account 858)	170	12	1507	19
Miscellaneous:				
Account 191	29	2	464	6
Storage	7	1	165	2
Other	1	*	831	11
Total	1375	100	7716	100

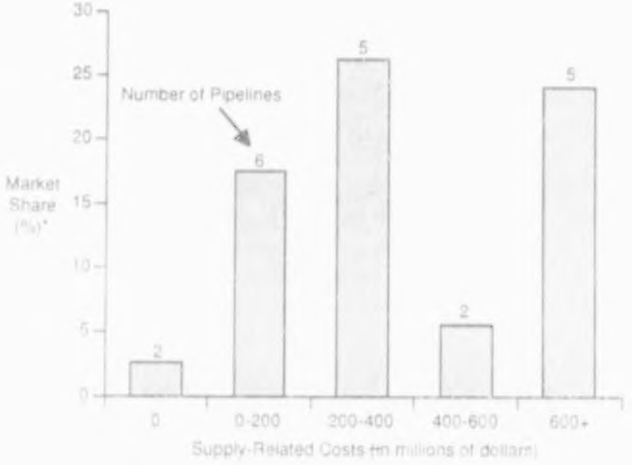
Notes: * Less than 1 percent.
Responses are from 20 pipelines representing 76 percent of 1989 natural gas deliveries.
"Other" includes gathering contract buyouts, LNG contract buyouts, unamortized system valuation, and deferred take-or-pay which may not be recoverable under the Order No. 500 recovery mechanism once comparability is established.

In both scenarios, buying out or buying down supply contracts makes up a strong majority of the supply-related transition costs. In the negotiated scenario, pipelines anticipate expenditures of $1.2 billion to buy out or down long-term supply contracts, making up 85 percent of the total supply-related transition costs. Another 12 percent, or $170 million, would come from renegotiating or terminating long-term contracts for firm transportation (Account 858). The balance of the costs in the negotiated scenario, 3 percent of the total, is related to Account 191, unused storage, and other miscellaneous categories such as buying out contracts for gathering systems.

Under the strict scenario, the numbers are much higher because many pipelines, though not all, feel that such a scenario would push them out of the merchant function entirely. In the strict scenario, pipelines estimated that they would incur $4.7 billion in supply contract buyouts or buydowns, or 62 percent of all supply-related costs. Costs to reform upstream transportation contracts accounted for $1.5 billion, or 19 percent of the total. Pipelines also expected to incur another $1.5 billion in other supply-related costs as shown in Table 1 under "Other," a category which includes gathering contract buyouts, LNG buyouts and deferred take-or-pay payments which may not be recoverable under the Order No. 500 recovery mechanism once comparability is established.

The distribution of these supply-related transition costs is quite different between the two scenarios. Whereas eight of the responding pipelines representing nearly a third of the market estimate that a flexible implementation of comparability, such as that contemplated in the negotiated scenario, could result in no supply-related transition costs, only two of the responding pipelines think that there will be no such transition costs under the strict scenario.[8] While few pipelines estimate significant supply-related transition costs under the negotiated scenario, five pipelines representing about a quarter of the market estimate that their transition costs are likely to be $600 million or greater under the strict scenario (see Figure 1).

Figure 1
Strict Scenario
Distribution of Pipeline Transition Costs



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[8] Transportation-only pipelines would have few or no supply related transition costs.

The difference in supply-related transition costs between the two scenarios means that the Commission has wide latitude in determining how costly completing the transition to comparability will be. Many pipelines believe that if the Commission permits a flexible, negotiated approach, they can work with parties in their proceedings to hammer out a form of comparability which both satisfies the parties and minimizes transition costs. On the other hand, pipelines attach a nearly $8 billion price tag to an inflexible approach to comparability which interprets "comparable" as "equal" and seeks to impose a generic form of comparability such as that described in the strict scenario.

Facility-Related Transition Costs

Responding pipelines also expect to incur costs to construct, upgrade, or expand facilities and operations in order to make pipeline services comparable. (See Table 2.) Under the negotiated scenario, pipelines expect to spend $220 million to accommodate comparability, with $137 million, or 62 percent of the total, for hardware, software, or administrative costs required to provide firm shippers with up-to-date information on scheduling, imbalances, curtailments, and system status. Pipelines would spend another $48 million, or 22 percent of total facilities costs, to upgrade or expand mainline or receipt point facilities to provide shippers firm capacity rights that are comparable to the pipeline as merchant. Additional facility costs include $25 million for storage. Annual operating costs for these facilities were not included in the totals.

Pipelines expect to spend over five times as much on facilities if they had to conform to the terms and conditions of the strict scenario, rather than the even-handed negotiated terms and conditions of the negotiated scenario. Under the strict scenario, pipelines estimate that nearly $1.9 billion in facility costs would be needed to accommodate the demands of comparability. This estimate includes roughly $270 million for real-time gas tracking, $220 million for storage facilities, and $1.3 billion for receipt point upgrades or mainline expansions.

Table 2
Facility and Operations Transition Costs for Comparability
(Millions of Dollars)

	Negotiated Scenario		Strict Scenario	
	($MM)	(%)	($MM)	(%)
Storage	25	11	224	12
Real-Time Gas Tracking	137	62	274	15
Gathering	10	5	70	4
Other*	48	22	1320	70
Total	**220**	**100**	**1888**	**100**

Notes: Responses are from 20 pipelines representing 76 percent of 1989 natural gas deliveries.
* "Other" includes one-time costs for construction or upgrade of mainline or receipt point facilities, and some propane facilities.

CONCLUSION

The interstate natural gas pipeline industry expects to experience a wide range of transition costs, depending on the form of comparability the Commission chooses to implement. The majority of these costs will come from gas supply contract buyouts or buydowns associated with changes in the pipeline merchant function. If pipelines have the option to negotiate on a fair basis the terms and conditions of comparable service, with guidelines that result in the intended goal of providing pipeline customers with meaningful choices for sales service, transition costs can be minimized and managed. However, if pipelines are required to meet rigid terms and conditions permitting shippers to offer a strictly equal merchant service, or if they must negotiate from a weakened position, transition costs will be substantially higher.

It is imperative that the Commission recognize its role in containing such costs and provide flexibility for pipelines to use the settlement process to achieve comparability, and at the same time include mechanisms for the recovery of transition costs that result from the implementation of comparability. Failure to do so will assuredly result in the same extensive court review and remands which brought uncertainty to the open-access proceedings and inhibited resolution of take-or-pay costs.

APPENDIX

Description of the Strict Scenario

1. Pipelines must unbundle currently bundled sales service into totally separate merchant and transportation functions. Firm sales customers must contract separately for transportation. The pipeline will retain no independent rights to capacity, including capacity for firm sales customers.

2. Each sales and transportation service must be identified, priced and made available separately, including such services as storage, gathering, transmission, and balancing.

3. The pipeline must provide some form of pooling on its system. FERC would adopt a rebuttable presumption that the pooling point would be at a mainline receipt point. Shippers, including the pipelines as merchants, must make their own transportation arrangements upstream of the pooling point. Distributors and end users would retain the right to firm capacity from the pooling point to the city-gate.

4. All shippers, including the pipelines as merchants, must have the same benefits and requirements. These include:

   — Equal firm capacity rights at all receipt points, and equal flexibility in changing receipt points and using other receipt points on an interruptible basis.

   — Equal firm capacity rights on mainline segments.

   — The same requirements with respect to nominations, scheduling, balancing, penalties, and access to receipt and delivery points.

5. Transportation service must include storage. The pipeline must offer firm and interruptible storage as part of its open-access transportation and provide equal capacity rights to firm storage. The pipeline may reserve storage only for its own merchant function, load balancing, and system management.

6. Upon a finding of comparability, the pipeline may receive pregranted abandonment authorization for its sales service.

7. The pipeline must implement capacity brokering and assignment. Rights to storage and other services must be in the brokering or assignment plan.

8. No service shall subsidize another. The pipeline's gas costs—including take-or-pay and buyout/buydown costs—must be recovered only from sales customers.

9. The pipeline must file tariff sheets showing compliance with these rules no later than six months after issuance of a final rule.

Office of the Consumers' Counsel
Columbus, OH, July 16, 1991.

Hon. Timothy E. Wirth,
Chairman, Subcommittee on Energy Regulation and Conservation, U.S. Senate, Committee on Energy and Natural Resources, Washington, DC.

Dear Senator Wirth: This is in response to the questions regarding S. 933, the Natural Gas Ratepayers Relief Act of 1991, in your letter of July 2, 1991. On behalf of the National Association of State Utility Consumer Advocates (NASUCA) and the Ohio Office of the Consumers' Counsel (OCC), I appreciate your interest in this bill and the opportunity afforded to testify in its favor before the Subcommittee on Energy Regulation and Conservation.

RESPONSES TO QUESTIONS REGARDING S. 933

The Subcommittee has asked whether statutory deadlines for the Federal Energy Regulatory Commission (FERC), as suggested at the June 19, 1991 hearing on S. 933, would affect FERC's administration of proceedings under Sections 4 and 5 of the Natural Gas Act and the rights of parties to such FERC proceedings.

NASUCA is on record in support of statutory deadlines for action by the FERC in a number of circumstances. I enclose NASUCA Resolution 91-9, adopted at the organization's May 1991 midyear meeting, calling for statutory deadlines for issuance of orders: (1) on rehearing; (2) on unopposed settlement proposals; (3) on remand from a reviewing court; and (4) following initial decision by an administrative law judge. The resolution points out that delays by the FERC cause prejudice to all parties, including consumers who may be paying excessive rates. To some extent our position is consistent with the suggestion that a statutory limit for action on a complaint filed under Natural Gas Act (NGA) Section 5 could benefit a complainant in obtaining relief from excessive rates.

It is clear, however, that a statutory limit on FERC action is insufficient as a solution to the problem addressed by S. 933, that relief under NGA Section 5 is prospective only. Only if refunds of excessive rates are permitted can ratepayers be protected to the same degree as are pipelines.

An example is a complaint filed in January 1986 against Northern Natural Gas Company. As the attached order shows, the FERC took final action on that complaint on July 5, 1991, dismissing it as moot. This is not, however, an instance in which ratepayers received no relief. Because the complaint was filed while the pipeline in question had a rate case under NGA Section 4 pending, relief was apparently obtained in connection with the rate case filing. The FERC order in the rate case issued December 22, 1986, just 11 months after the complaint was filed. The order approved a settlement establishing reduced rates, retroactive to the effective date of the pipeline's Section 4 rate filing. Eleven months is relatively prompt; yet if the complaint had been only under Section 5, with relief prospective only, ratepayers would have had no remedy for the excessive rates paid during that eleven month period.

In most instances, of course, if there were a litigated complaint proceeding, the complexity of the analysis once a complainant obtains the necessary data from a pipeline requires that sufficient time be allowed for both sides to present their evidence. A statutory deadline could operate to prevent the complainant from obtaining sufficient evidence to support its burden of proof.

We believe that statutory deadlines in the situations enumerated in the NASCUA resolution can be accommodated by the FERC without injury to the Commission's administration of cases. The circumstances listed are those where litigation has been completed. As consumer advocates, NASUCA members are wary of measures which could produce unfair results by limiting the ability of advocates to present necessary evidence, especially when that evidence must be obtained by discovery from the pipeline.

Certainly NASUCA supports a deadline for FERC to issue a final order following completion of an evidentiary proceeding and/or following the filing of a settlement proposal in any FERC proceeding. However we do not consider such deadlines to be an adequate substitute for the refund protection embodied in S. 933.

NASUCA is willing to work with your staff and with subcommittee members to ensure legislation which properly addresses the inequities for ratepayers under NGA Section 5. While we believe that S. 933 would achieve this end, we are available to discuss possible changes which could still provide ratepayer relief. To reiterate, we do not believe a statutory deadline would be sufficient, nor would it fairly balance the rights of consumers and regulated gas companies.

Very truly yours,

MARGARET ANN SAMUELS,
Chair, NASUCA.

[Enclosure.]

RESOLUTION 1991-9

URGING THAT THE CONGRESS ADOPT PROPOSED CHANGES TO THE NATURAL GAS ACT WHICH WOULD REQUIRE DEADLINES FOR FINAL ACTION BY THE FERC REGARDING UNOPPOSED PROPOSED SETTLEMENTS, APPLICATIONS FOR REHEARING, DECISIONS ON REMAND AND THE AVOIDANCE OF UNREASONABLE DELAYS IN THE ISSUANCE OF INITIAL DECISIONS

WHEREAS, The Natural Gas Act provides that an application to the Federal Energy Regulatory Commission (FERC) for rehearing is a prerequisite to any judicial review of a Commission order; and

WHEREAS, No time limits for FERC action on initial decisions, decisions on remand from a reviewing court, or adoption of settlements currently exist, while a tolling order may delay action on applications for rehearing; and

WHEREAS, Undue prejudice to all parties, including state utility consumer advocates wishing to appeal from FERC orders, as well as consumers who may be paying excessive rates, can result from the FERC's delay in acting upon these issues; and

WHEREAS, Undue delay in acting upon applications for rehearing, decisions on remand or adoption of unopposed settlements may unjustly delay implementation or judicial review of FERC orders; and

WHEREAS, Proposals pending before Congress would modify the rehearing procedures under the Natural Gas Act by establishing time limits under which the FERC must act on an application for rehearing.

THEREFORE, BE IT RESOLVED that the National Association of State Utility Consumer Advocates supports federal legislative action that specifically establishes a day time limit for FERC to grant or deny applications for rehearings, a similar limit for action on unopposed proposed settlements and judicial remands, and legislation to preclude unreasonable delays in the issuance of orders following initial decisions.

BE IT FURTHER RESOLVED that NASUCA authorizes the Executive Committee to develop specific positions and to take appropriate actions consistent with the terms of this resolution. The Executive Committee shall advise the membership of any proposed action prior to taking such action if possible. In any event, the Executive Committee shall notify the membership of any action taken pursuant to this resolution.

Approved by NASUCA: Seattle, WA, May 21, 1991.

Submitted by: NASUCA Gas Committee.

UNITED STATES OF AMERICA 56 FERC 61, 036

FEDERAL ENERGY REGULATORY COMMISSION

Pipeline Rates: Complaint

Before Commissioners: Martin L. Allday, Chairman; Charles A. Trabandt, Elizabeth Anne Moler, Jerry J. Langdon and Branko Terezic.

Minnesota Public Utilities Commission and Department of Public Service, Iowa State Commerce Commission, and Peoples Natural Gas Company, Division of UtiliCorp United Inc. v. Northern Natural Gas Company (Docket No. RP-86-46-000).

ORDER DISMISSING COMPLAINT AS MOOT AND TERMINATING PROCEEDING

(Issued July 5, 1991)

On January 28, 1986, the Minnesota Public Utilities Commission and the Energy Issues Intervention Office of the Minnesota Department of Public Service (the Minnesota Agencies), the Iowa State Commerce Commission (ISCC), and Peoples Natural Gas Company (Peoples) filed a complaint and motion for summary judgment against Northern Natural Gas Company (Northern) in the above-captioned proceeding. The complainants asked the Commission to order Northern to immediately reduce its rates to reflect the additional net jurisdictional revenues that resulted from the sale of Peoples, then a division of InterNorth, Inc. and an affiliate of Northern, to UtiliCorp United, Inc.

The complaint filed by the Minnesota Agencies, ISCC, and Peoples in this proceeding has been rendered moot by a settlement filed on April 11, 1986, and approved by the Commission on December 22, 1986, in Docket No. RP85-206-000.[1] The April 11, 1985 settlement resolved all issues dealing with Northern's revenues and expenses. Therefore, the Commission dismisses the complaint as moot and terminates the proceedings in Docket No. RP86-46-000.

The Commission orders:

The complaint filed by the Minnesota Agencies, ISCC, Peoples in Docket No. RP86-46-000 is dismissed as moot, and the proceeding in this docket is terminated.

By the Commission.

LINWOOD A. WATSON, JR.,
Acting Secretary.

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[1] 37 FERC 61,272 (1986), reh'g granted in part, and denied in part, 41 FERC 61,158 (1987), aff'd Mobil Oil Corp., et al. v. FERC, 886 F.2d 1023 (8th Cir. 1989).

APPENDIX II

Additional Material Submitted for the Record

PREPARED STATEMENT OF PETER BRADFORD, CHAIRMAN, PUBLIC SERVICE COMMISSION, STATE OF NEW YORK

I have been involved in utility regulation for 20 years, as chairman of a small state commission (Maine), as chairman of a large state commission (New York), and as a commissioner of a federal agency (the NRC). I have also served as President of the National Association of Regulatory Utility Commissioners. In addition to my comments on the S. 933 proposal, I will also address another natural gas proposal before the Senate, S. 1220.

To put my concerns in perspective, let me provide you with a snapshot of the gas industry in New York. Nineteen gas distribution companies provide service to approximately 4,100,000 consumers, 3,800,000 of whom are residential. In 1990, a total of 945,000,000 Dts of gas were used in various applications. That represents approximately 5% of the amount of natural gas available to the United States in 1990, and ranked us as the sixth largest consuming state. All but 2.5% of our gas requirements were met from out-of-state sources.

New York has had an active intervention program before the Federal Energy Regulatory Commission and its predecessor, the Federal Power Commission, going back to the 1950's. I believe we are the most active consuming state intervenor. Based upon this experience I believe that S. 933 should be enacted into law.

The revisions to Section 5 are necessary to eliminate a glaring unfairness to consumers. Current law permits pipelines to benefit from delay at FERC when their rates are too high but to receive instant relief—through rate increases subject to refund—when their rates are too low. Section 5 proceedings typically take several years to process. Fundamental fairness requires that the consequence of extended FERC proceedings be shared in the same manner whether rates are too high or too low. S. 933 would achieve this result.

By way of example, National Fuel Supply Corporation was found in 1989 to have been charging rates that were some $11 million per year too high. The case had lasted more than three years. The absence of a symmetrical refund provision resulted in excess earnings of some $33 million between 1986 and 1989.

Although the delay inherent in obtaining rate changes under Section 5 is an old problem, pipelines typically requested rate increases almost annually during the late 1970's and early 1980's. Thus, the Commission's authority to order refunds on any portion of the proposed rate increase found to be excessive prevented the pipeline from continuing to collect unreasonable rates. Frequent rate increase requests were a result of the constantly increasing cost of gas and inflation during the late 1970's and early 1980's, coupled with the pipeline industry's continuing investment in facilities both to bring on new supplies developed in outlying areas, and to service new markets. Even in situations where a pipeline was not adding plant, and otherwise had no need to seek annual revenue adjustments, purchase gas adjustment (PGA) regulations required the pipeline to submit its rates for review every three years.

However, circumstances in the industry have changed over the past few years in ways that will permit pipelines to charge excessive rates for extended periods of time unless interim refund authority is provided under Section 5. For instance, many major interstate pipelines are not investing in new plants to bring on system supplies, as they did in the past. Instead, they are forming discrete pipelines for the sole purpose of transporting customer-owned gas from new sources of supply. Except for the addition of compression or isolated looping, both requiring relatively small capital expenditures but which significantly increase throughput, there is little additional investment required over the life of the facilities. For the most part, these projects are highly debt-leveraged ventures requiring a short payback period (20 years or less). Thus, with constantly declining rate base, these pipelines have little need to file for rate increases under Section 4. Furthermore, since they operate as transportation only pipelines they are not subject to the Commission's requirement that pipelines with purchase gas adjustments file for periodic rate review.

In addition, as pipelines that do retain a merchant role are moving away from purchase gas adjustment clauses toward using market-based gas inventory charge mechanisms, they are relieved of the requirement to submit their rates for review under Section 4.

Section 5 review, therefore, becomes the only mechanism available to the states and the local distribution companies for review of pipeline rates. Amending Section 5 to provide for refunds is good public policy. Consumers should not have to wait several years until the Commission takes final action in order to obtain relief from unjust and unreasonable rates.

Congress recognized this inequity on the electric side when it amended the Federal Power Act in 1988 to permit refunds regardless of whether the utility filed for rate relief or the Commission, on its own motion or pursuant to complaint, reviewed a utility's rates. There is no reason that consumers of natural gas should be treated any differently than are consumers of electricity.

As a final matter, I would like to comment on the Natural Gas section of S. 1220 as it was recently reported out of Committee. S. 1220 would provide pipelines with a variety of new regulatory options that would expedite pipeline construction and would eliminate FERC approval and review of negotiated rates for these new services.

S. 1220 would permit initial rates for services resulting from new pipeline construction to be exempt from FERC's rate setting authority under Section 4 of the Natural Gas Act (rates presumed to be "just and reasonable" under Section 4). Moreover, Section 5, and the proposed amendment thereto, would no longer apply to pipelines constructed under the Optional Certificate proceeding (§ 1101). Apparently, these proposals are aimed at eliminating regulation in the name of competition.

New York has been involved actively in the move toward greater deregulation of the natural gas industry and has taken the position in proceedings before FERC that market based sales rates should be adopted in cases where pipeline customers (including local distribution companies) have access to the essential facilities necessary to allow them to purchase gas in the market. We continue to believe, however, that regulation is required in those instances where a competitive market does not exist.

Because virtually all new pipelines are constructed for the purpose of providing transportation for customer owned gas, deregulation of transportation rates only makes sense if there is a competitive market for such transportation services. The test for competition must be whether customers actually have access to alternative sources of transportation. Otherwise, deregulation is just a formula for unregulated monopoly and for the Cable TV types of abuses that go with it.

In the Northeast such competition is often absent. For instance, in the New York City area, the three pipelines providing transportation have no excess peak capacity. New pipelines are extremely difficult to site and are not being constructed to compete with existing ones, but rather to supplement available service. Thus, to meet both their existing and expected growth in demand for natural gas, local distribution companies have no alternative but to take service from existing transporters with substantial market power and to become fully committed to new entrants into the area. I assume there are many other parts of the country facing the same situation.

Since there is little competition at this time, Congress should continue to allow FERC to review and approve rates for new interstate pipeline transportation services and should not prohibit the states and interested parties from filing complaints under Section 5. Because states would be unable to review the reasonableness of the rates agreed to by their local distribution companies, without FERC regulation essential monopoly services would go unregulated and the detriment to consumers could be enormous. Deregulation of transportation should not occur until real competition is shown to exist.

I am also concerned that any congressional effort to streamline pipeline regulation, as proposed in S. 1220, does not result in the abandonment of our commitment to the environment. Under the National Environmental Policy Act (NEPA), major federal actions that significantly affect the quality of the environment are subject to environmental review. However, both the optional certificate and streamlined certification sections of the bill (Sections 1101 and 1109) are sufficiently ambiguous so as to raise serious concerns about whether Congress intends to require FERC to continue its environmental review under the NEPA prior to pipeline construction, and whether Congress intends that FERC continue to attach environmental conditions to its certification of new pipelines.

Although I understand these issues were raised during the hearings on the bill, the language of the bill appears unchanged. I cannot imagine that Congress would permit major pipeline construction to commence absent environmental review. Congress must insist that NEPA apply to all construction of major interstate pipelines and that FERC continue to attach environmental conditions to new certificates. If pipeline construction is not required to be reviewed at the federal level, then states must not be preempted from conducting expeditious environmental review.

Furthermore, pipelines should not be vested with the powers of eminent domain that attach to FERC certification, absent environmental review. The provision of the bill allowing outside consultants to prepare environmental documents and designating FERC as the lead federal agency for NEPA compliance should alleviate some concerns regarding certification delay. And, the proposal prohibiting pipeline companies which select the optional certificate procedure from participating in any other certificate proceeding to serve the area in which they are authorized to serve would eliminate one of the major causes of delay in pipeline construction (Section 1110). Pipeline certification could also be expedited if FERC were required to accept state environmental review in instances where both the states and FERC retain jurisdiction.

In conclusion, the amendment to Section 5 of the NGA, as contained in S. 933, is an important element in protecting consumers during this major transition in the regulation of the natural gas industry. Moreover, I urge you to proceed cautiously as you consider S. 1220. Deregulation can only work if viable competition is shown to exist and, therefore, FERC should be permitted to continue to review pipeline rates and allow for market based pricing only if it can be shown that real competition exists. Finally, adequate environmental protection must not be sacrificed.

Prepared Statement of the Natural Gas Supply Association

The Natural Gas Supply Association (NGSA) welcomes this opportunity to comment on S. 993, the Natural Gas Ratepayers Relief Act of 1991. For the reasons discussed below, NGSA supports periodic rate reviews, opposes amending Section 5 of the Natural Gas Act (NGA), and suggests an alternative approach to refunds under NGA Section 4.

Natural Gas Supply Association (NGSA) is an association whose membership comprises both major and independent producers and marketers of natural gas. Approximately 90% of the natural gas produced and marketed in this country is produced by NGSA member companies.

PERIODIC RATE FILINGS

NGSA supports Section 2(b) of S. 993, which would require pipelines to restate their base tariff rates. In the face of significant depreciation, declining interest rates, and increasing throughput, there is a significant likelihood that the pipelines' cost of service will continue to decline over the foreseeable future. Periodic rate review will ensure that those cost reductions flow to the customers, rather than being trapped inside stale, inflated rates.

REFUND OBLIGATION UNDER SECTION 4

As currently written, NGA Section 4(e) arguably permits refunds only when the pipeline files a rate increase, and are limited to the amounts of the filed rate increase, even if the Commission determines that the just and reasonable rates should be lower than those previously approved. Section 2(a) of S. 993 proposes to expand the Commission's authority to order refunds. Under S. 993, the Commission would be authorized to impose refund obligations for any rate change filing, whether an increase or decrease, and for an amount reflective of any newly authorized rates, even if lower.

NGSA agrees that potential refund should accrue from the date of a rate filing, and that this refund obligation should extend down to whatever new level the Commission finds to be just and reasonable. Refund liability should not be limited to the rate last approved by the Commission. NGSA is concerned, however, that S. 993 would discourage pipelines from filing for rate decrease, since such a filing would expose a pipeline to unlimited rate reductions and retroactive refunds. NGSA recommends that the expanded refund obligation set out in S. 993 should be applied to periodic rate reviews. Accordingly, whether a pipeline's periodic rate filing calls for a rate increase or decrease, the refund obligation should extend to whatever rates the Commission finds just and reasonable—even if those approved rates are lower than previously approved rates, and even if the approved rates are lower than the rates in the pipeline's restatement filing. Furthermore, NGSA would recommend that pipelines be required to file rate reviews every three years.

Unlike Section 4, Section 5 cases can be brought by anybody, including the Commission. NGSA opposes Section 2(c) of S. 993, which proposes to amend NGA Section 5. The proposed amendments would have at least three negative effects. First, by creating the possibility of refunds, Section 2(c) would encourage many parties to file Section 5 complaints reflexively. As a result, pipeline rates would rarely, if ever, be final. Permanent rate uncertainty would be harmful to the industry as a whole and all its participants, including consumers. Second, a mushrooming Section 5 caseload would also force the Commission to divert resources from other productive matters. Third, since refunds insulate complaints from the effects of administrative delay, the proposed amendments may actually slow down the Commission's disposition of Section 5 cases.

Finally, NGSA believes that the proposed amendments to NGA Section 4, discussed above, will very likely solve the problem of unjustified and excessive pipeline rates without further action regarding Section 5, and NGSA always favors the least intrusive legislative action that will resolve a matter.

STATE OF NORTH DAKOTA,
PUBLIC SERVICE COMMISSION,
Bismarck, ND, June 25, 1991.

Hon. TIMOTHY WIRTH,
Subcommittee on Energy Regulation and Conservation, Energy and Natural Resources Committee, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: I read with interest the reports of your committee hearings pertaining to Senator Metzenbaum's proposals to amend sections 4 and 5 of the Natural Gas Act to provide, among other things, for refunds below the final just and reasonable rate.

Last July, the Gas Committee of the National Association of Regulatory Commissioners, of which I am a member, considered a resolution in support of legislation consistent with the Metzenbaum proposal relative to section 5. The Committee voted 15 to 4 in opposition to such a resolution. I was one of the 15.

I take this opportunity to express my strong opposition to the current Metzenbaum amendments. They are unnecessary and would cause uncertainty for all concerned: pipelines, State Commissions, and consumers. The NARUC Gas Committee vote of last July is, I believe, indicative of the position of the vast majority of state regulators.

If the record of the hearing is still open, I request this letter be included in it.

Sincerely,

LEO M. REINBOLD,
Commissioner.

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,
BOARD OF DIRECTORS,
Washington, DC, July 19, 1991.

Hon. TIMOTHY WIRTH,
Chairman, Subcommittee on Energy Regulation and Conservation, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The FERC is providing you with some statistics on pipeline rates of return. The Commission staff has been calculating the rates of return based on data filed with the FERC on its Form 2. I would like to share with you a copy of a letter from INGAA to Chairman Martin Allday detailing our concerns about calculating rates of return from Form 2 data.

As noted in the attached letter, filings with the Securities and Exchange Commission (SEC) are a more appropriate source of information. Data from the SEC forms for 1989, analyzed using generally accepted accounting principles, show average pipeline returns on equity of 9.4%.

Please do not hesitate to contact me or INGAA if you have any questions.

Sincerely,

RONALD L. KUEHN, JR.,
Chairman.

[Enclosure.]

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,
Washsington, DC, July 18, 1991.

Hon. MARTIN L. ALLDAY,
Chairman, Federal Energy Regulatory Commission, Washington, DC.

DEAR CHAIRMAN ALLDAY: On May 10, 1991, the Federal Energy Regulatory Commission held a public conference in FERC Dockets RM91-11-000, et al., which contemplates a major restructuring of the natural gas industry. On the topic of paying for the transition to comparability, Mr. Nicholas Bush, president of the Natural Gas Supply Association (NGSA), testified that interstate natural gas pipelines have "excellent financial health" and that, "they're more than capable of handling what small transitional costs there will be." Mr. Bush made these claims based on a recently completed NGSA study [1] which he indicated would be provided to the Commission.

The purpose of this letter is to correct the NGSA study and Mr. Bush's statements. First, the NGSA study contains a number of errors that lead to higher rates of return on equity than those calculated from financial data filed with the Securities and Exchange Commission (SEC) and prepared according to generally accepted accounting principles. Second, the recovery of transition costs should not be linked to the financial strength or weakness of the pipeline industry, but rather pipelines should be permitted to fully recover all prudently incurred costs. Uncorrected, the NGSA study could mislead the formulation of public policy, especially with respect to the implementation of comparability.

The NGSA study relies almost exclusively on FERC Form No. 2 (Form 2) data, which is most useful in reporting to the Commission on broad operational and financial aspects of a pipeline company, but is not designed or suitable for comparative financial analysis between industries. Indeed, financial analysts rarely rely on Form 2 as a source for information. In addition, the study uses incorrect estimates in place of key data items to create financial statistics from Form 2 data. The result is an analytical framework which does not accurately reflect the industry's financial performance and leads to a number of the erroneous results. In particular, the study uses a "hypothetical rate base" approach to estimate capitalization of pipeline companies. This approach is based on unclear reasoning and requires extensive recalculations of capital assets as reported in Form 2. This inappropriate use of Form 2 data as the basis for inter-industry comparative financial analysis renders the study useless.

In calculating rates of return on common equity (the ratio of net pipeline incomes to the portion of pipeline assets financed by common stocks), the NGSA study methodology in many cases:

- Overstates net income (the numerator) by understating interest expenses and the resulting income taxes.
- Understates the equity portion of pipeline assets (the denominator) by assuming that a pipeline's capital structure is the same as that of the diversified parent that filed the Form 2.

To demonstrate the impact of these flaws in methodology, when Form 2 data for the same group of 25 pipelines examined in the NGSA report are used unchanged, the composite rate of return on equity is calculated to be 10.28%, or only sixty percent of the 16.43% figure reported by the NGSA.[2]

A more appropriate basis for calculating rates of return is data from financial reports filed with the SEC by companies having publicly traded securities. The NGSA figures are again much higher when compared to rates of return on equity based on data from SEC Forms 10-K and U5S. The overall return on equity for twelve pipelines [3] computed from SEC data is about 9.4% whereas the returns for the same pipeline companies from the NGSA report is 18.5%. Given that the NGSA has relied heavily on SEC reports in the past to calculate pipeline take-or-pay payments, it is curious that the NGSA now ignores these sources in calculating financial performance ratios.

The following examples will give you more specific details on the type of errors that undermine the NGSA study:

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[1] Financial Performance of Major U.S. Interstate Natural Gas Pipelines, 1980-1989, Natural Gas Supply Association, February 1991.

[2] *Ibid.*, page A-6, and Summary Table 1.

[3] These are ANR, Colorado Interstate, Columbia Gas, Columbia Gulf, El Paso, Northwest, Panhandle Eastern Pipeline and Trunkline combined, Southern Natural, Texas Eastern, Texas Gas, and Transco.

- The NG study categorically substitutes derived interest expenses in place of substantially higher actual interest costs as reported in Form 2. In addition, the NGSA's methodology ignores the impact of lower interest expense on income taxes and exacerbates the overstatement of pipeline income. Using Texas Eastern Transmission as an example, the study's methodology results in a $5 million overstatement of income and a $374 million understatement of capital investment leading to a return on equity rate of 18.2%, more than double the 8.5% rate calculated from publicly available data filed with the SEC. On a similar basis, the NGSA reported a return for El Paso of 17.00%, whereas the figure calculated from SEC data is just under 10.00%.
- In a number of cases, the NGSA study used the capital structure of a more highly leveraged parent company, when that is the structure reported in Form 2, instead of the structure specific to the pipeline subsidiary, again leading to higher rates of return. Consider for example a pipeline company with a 50% debt and 50% equity capital structure that has a return on equity of 10%. If that pipeline is held by a parent company with a more leveraged capital structure of 67% debt and 33% equity and those figures are used to calculate the pipeline's rate of return, the result would be about 15%. The study's inaccurate estimation of such a key parameter as the capital structure results in erroneous rates of return. In the above example, using one-third equity instead of half, results in a fifty percent overstatement of the rate of return. The use of inaccurate capitalization ratios was identified in spot checks of NGSA calculations for Northern Natural, Northwest, Panhandle Eastern Pipeline, and Tennessee Gas.
- Finally, the NGSA study is prone to use income for a diversified parent company, including such non-pipeline revenues as income from distribution, marketing and other operations, to highly exaggerate the net income available to common equity for the pipeline division. Specifically, the NGSA study uses the $177.5 million net income for the parent company Arkla Inc. instead of the actual net income for Arkla Energy Resources, the pipeline division, which is an order of magnitude smaller. The study then proceeds to use the capital assets of the parent company to concoct an equity estimate for the pipeline division that does not even remotely relate to the assets of the pipeline. The calculated rate of return in this case is totally without foundation.

In short, the conclusions reached by the NGSA about the financial health of the industry are based on flawed analysis. Moreover, it is hard to see the relevance of past financial performance to the future health of pipelines given all the unknowns facing the industry. As an unfortunate example, the NGSA study incorrectly reports[4] a 31.34% rate of return for Columbia Gas in 1989.[5] The company recently reported that it is experiencing financial difficulties which could require it to seek protection under bankruptcy laws.[6]

The Commission should avoid basing any decisions on such a factually incorrect study as the one performed by the NGSA.

Sincerely,

JERALD V. HALVORSEN,
President.

THE STATE OF WYOMING,
PUBLIC SERVICE COMMISSION,
Cheyenne, WY, July 31, 1991.

Hon. TIMOTHY WIRTH,
Chairman, Subcommittee on Energy Regulation and Conservation, Dirksen Senate Office Building, Washington, DC.

DEAR MR. CHAIRMAN: I have heard of your subcommittee hearing on June 19 on S. 933, Senator Metzenbaum's legislation to amend sections 4 and 5 of the Natural Gas Act (NGA) to change rate proceedings for natural gas interstate pipelines and to eliminate the refund floor under section 4 and provide for retroactive refunds under section 5.

Under section 4 of the Natural Gas Act (NGA), a natural gas company has the right to propose new rates through a filing with the Federal Energy Regulatory Commission (FERC). New rates, whether higher or lower than existing rates, become final only after the FERC has reviewed them extensively and, after notice and opportunity for the public to participate, deemed them just and reasonable. To ensure continued customer protection, section 5 gives the FERC the right to undertake an investigation on its own motion or complaint by others of previously approved rates. If the FERC finds the existing rates are no longer just and reasonable, it will set new just and reasonable rates for collection thereafter. The rates found to be just and reasonable by FERC under either section 4 or 5 are final rates.

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[4] Ibid., Section A, Table 2.

[5] The rate of return on common equity for Columbia Gas in 1989 when calculated from SEC data is about 9.35%.

[6] Press Release by The Columbia Gas System, Inc., Wilmington, Delaware, June 19, 1991.

Senator Metzenbaum's bill, S. 933, abrogates the final rate doctrine, which has been upheld by the courts, by eliminating the floor for rate refunds under section 4 and by providing that FERC shall provide refunds under section 5. Both of these provisions would provide great uncertainty to interstate pipelines, regulators, customers and investors alike. Final rates assure the capital markets that pipelines have the necessary stream of income to support loans, bonds and other financial instruments. Final rates also permit customers of a pipeline to know the costs they will incur from use of the pipeline regardless of economic conditions. However, S. 933 can produce the undesired result that no rate ever becomes final.

Since S. 933 would provide for rate decreases retroactively, it can be argued that FERC should also be granted the authority to increase rates retroactively. As a state regulator, I cannot support proposals which would eliminate final rates. I believe that both the customer and the utility should know when the rate is final.

The pipeline industry has been restructured and continues in a period of transition and restructuring. The purpose of these changes is to allow competition to have a greater impact on assuring market-responsive just and reasonable rates. To inject further regulatory requirements on the FERC, and uncertainty upon the customers, is consistent with greater reliance on competitive forces. Finally, there has been no showing of need for this type of legislation.

I would appreciate having this letter included in the record of the hearing.

With all best wishes,

JOHN R. SMYTH,
Deputy Chairman.

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